# 2005 Annual Report

## Alberta Heritage Savings Trust Fund

Alberta

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# Minister of Finance's Report to Albertans on the Alberta Heritage Savings Trust Fund

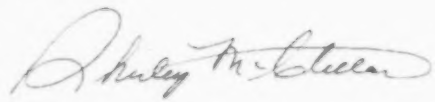
It is an honour to present the 29th Annual Report of the Alberta Heritage Savings Trust Fund. The Heritage Fund has become a unique symbol of pride to Albertans and an illustration of forward thinking and long-range planning by the Government of Alberta.

The Heritage Fund was created in 1976 when the oil and gas sector was booming. Back then, it was decided to invest a portion of the non-renewable resource revenue for the benefit of future generations of Albertans. The investment income generated in the Fund is transferred to the Province of Alberta's main operating account, the General Revenue Fund, where it is used for Albertans' priorities such as health care, education, roads and tax reductions.

I am very pleased to report the Heritage Fund earned $1.1 billion from its investments in fiscal 2004-05. All of the investment income was transferred to the General Revenue Fund during the year. Since 1976, total transfers to the General Revenue Fund have grown to $27.6 billion.

The fair value of the Fund's net assets was $12.2 billion at March 31, 2005. The Fund's assets are invested around the world in a diversified portfolio of investments, which includes stocks, bonds, and real estate.

With strong leadership and fiscal management, the Heritage Fund remains a cornerstone of Alberta's financial structure and will continue to play a growing role in the future of Alberta as a debt free province.



Honourable Shirley McClellan
Minister of Finance

# Fund Governance

- The Heritage Fund was established in 1976 and operates under the authority of the *Alberta Heritage Savings Trust Fund Act*. On January 1, 1997, a new *Act* was passed that sets out a revised investment framework for the Fund.

- The Standing Committee on the Alberta Heritage Savings Trust Fund reviews and approves the business plan and annual report of the Fund. The Standing Committee has representation from the major parties of the legislature. The Standing Committee receives regular reports on the performance of the Fund and conducts public meetings on an annual basis in different locations in the Province. The purpose of these meetings is to update Albertans on the management of the Fund and to solicit input from Albertans on the Fund's objective.

- The Ministry of Finance is responsible for the Fund and its investments. The Minister of Finance is required to report on the performance of the Fund quarterly within 60 days of the end of the quarter and make public the annual report within 90 days of the end of the fiscal year.

- The business plan of the Heritage Fund is published as part of the provincial budget and the income of the Fund is consolidated into the revenue of the Province.

- An Endowment Fund Policy Committee (EFPC) was established last year to add private sector financial and business advice regarding the Fund's investment policies. The EFPC is chaired by the Minister of Finance and consists of private sector members and government MLA's. The Committee reviews and makes recommendations to the Minister with respect to the business plan, annual report and investment policy statements for the Fund. The Committee meets at least quarterly to review performance and fund management.

- The investment portfolio of the Heritage Fund is managed by a group of highly qualified and experienced professionals in Alberta Finance. External managers (specialized private sector investment managers) are used to manage specific investment mandates.

# Business Plan

## PURPOSE

The business plan of the Heritage Fund describes the mission, goals, investment objective, and how the Fund's performance will be measured. The business plan is reviewed annually and is published as part of the Provincial budget. The Endowment Fund Policy Committee (EFPC) reviews and makes recommendations regarding the business plan and the investment policies for the Fund. The business plan is then reviewed and approved by the Minister of Finance, the Treasury Board and the Legislature's Standing Committee on the Alberta Heritage Savings Trust Fund.

## MISSION

The statutory mission of the Fund is:

> **"To provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans."**

## INVESTMENT OBJECTIVE

The investment objective of the Fund is to maximize long-term financial returns subject to an acceptable level of risk. By legislation, Alberta Finance operates under the "Prudent Person Rule". This assigns to the investment manager the responsibility to restrict investments to assets that would be approved by a prudent person. Investment funds with long-term investment horizons and an objective to optimize long-term returns, invest a significant amount of their assets in equities since equities have historically provided investors with higher total returns (dividends and capital gains) than interest bearing securities. The Heritage Fund follows a similar strategy to achieve higher financial returns. However, this can result in more volatility in capital gains and less interest income. For example, Canadian equities and long bonds from 1924 to 2003 show that the annual compound return was 10.0% and 6.1% respectively but the standard deviation of annual returns for equities was 18.7% versus 8.9% for long bonds.

## GOALS AND OUTCOMES

The five main outcomes of the Fund, as outlined in the 2004-07 business plan remain as follows:

1. Maintain nominal value of assets at a 5-year planning horizon.
2. Achieve budgeted cumulative income forecasts during a 5-year planning horizon.
3. Preserve the real value of assets over a long-term horizon of 20 years.
4. The Heritage Fund policy asset mix is expected to generate a total real rate of return of 4.5% at an acceptable level of risk over a moving five-year period.
5. The market rate of return is expected to be greater than a passively invested benchmark portfolio by 0.50% per year (after fees are deducted) by adding value through active management.

## PERFORMANCE MEASURES

The Heritage Fund business plan outlines various performance measures and benchmarks, which are reviewed annually to determine ongoing suitability.

The 2004-07 Business Plan incorporated the following major changes to the long-term policy asset allocation:

- Increase investments in absolute return strategies from 5.0% to 7.5%.
- Reduce investments in bonds to accommodate the increase in absolute return strategies.
- The benchmark return for United States equities changes from the Standard & Poor's 500 to the Standard & Poor's 1500.

The following table summarizes the long-term investment policy weights and benchmark return indices by asset class in the 2004-07 business plan.

| ASSET CLASS | Long Term Policy Allocation 2004-05 | 2003-04 | Benchmark Return Index |
|---|---|---|---|
| **Fixed income:** | | | |
| Money market | 2.0% | 2.0% | Scotia Captial 91-Day T-Bill |
| Bonds | 30.5% | 33.0% | Scotia Captial Universe Bond Index |
| | **32.5%** | **35.0%** | |
| **Public equities** | | | |
| Canadian | 15.0% | 15.0% | Toronto Stock Exchange (S&P/TSX) Composite Index |
| United States | 15.0% | 15.0% | Standard & Poor's (S&P) 1500 Index |
| Non-North American | 15.0% | 15.0% | Morgan Stanley Capital (MSCI) EAFE Index |
| | **45.0%** | **45.0%** | |
| **Real Estate** | **10.0%** | **10.0%** | Consumer Price Index (CPI) plus 5% |
| **Absolute Return Strategies** | **7.5%** | **5.0%** | Consumer Price Index (CPI) plus 6% |
| **Private equities** | **5.0%** | **5.0%** | Consumer Price Index (CPI) plus 8% |
| | **100.0%** | **100.0%** | |

# The Year in Review

(April 1, 2004 to March 31, 2005)

## MARKET SUMMARY

The Canadian equity market had strong investment returns this year. The Toronto Stock Exchange S&P/TSX Index, which measures the performance of Canada's top companies, reported an increase of 13.9% compared to an increase of 37.7% the previous year. Higher personal consumption, low interest rates, surging employment, strong exports, and rising disposable income contributed to the buoyant economy. The housing market in particular, continued to be robust.

Oil prices increased to record levels during the year before settling down by year-end. At the beginning of the year, West Texas Intermediate (WTI) opened the year at $35.78 US per barrel and closed at $55.41 US per barrel by year-end. The energy sector led all other sectors in the S&P/TSX Index returning 43.6% over one year.

The US dollar continued its decline against the Canadian dollar. By March 31, 2005, $1 US purchased $1.21 Canadian compared to $1.31 Canadian at the beginning of the year. As a result, the value of the Fund's US equity investments declined when translated into Canadian dollars resulting in lower investment returns.

At March 31, 2005, the Bank of Canada overnight rate was 2.5%, while the US Federal Reserve Fund rate ended the year at 2.75%.

Equity markets in the U.S. grew at a more modest pace. While capital investment was strong, other indicators, such as weaker than expected employment numbers and lower than expected consumer spending, resulted in modest growth. In addition, record oil prices during the year inhibited growth in the U.S. economy. The S&P 1500 Index, which tracks the performance of the top 1500 American companies increased by 7.2% over the year in U.S. dollars and negative 1.0% in Canadian dollars. Currency movements had a negative impact, pulling the U.S. returns down when translated into Canadian dollars.

Non-North American markets performed well. The Morgan Stanley Capital International Index for Europe, Australasia, and the Far East, MSCI EAFE Index, measures the performance of approximately 1,000 companies on 21 stock exchanges around the world. The index increased by 9.4% during the year in local currency and 6.2% in Canadian dollars. Growth in demand from China continued to be strong, keeping commodity prices firm. The Japanese economy showed growth due in part from exports to China. Activity in Europe has improved somewhat, while growth in the Euro-Zone remained modest. France and Germany posted weak numbers in employment and for domestic and foreign demand.

### MAJOR INDICES

Year ended March 31, 2005

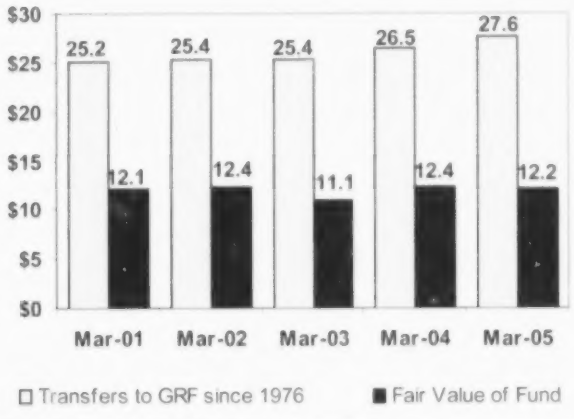
| | 2005 % | 2004 % |
|---|---|---|
| **Stock Markets** | | |
| Canadian | | |
| *S&P/TSX Index* | 13.9 | 37.7 |
| United States | | |
| *S&P 1500 Index (US $)* | 7.2 | 36.9 |
| *S&P 1500 Index (Cdn $)* | (1.0) | 22.1 |
| Non North American | | |
| *MSCI EAFE Index (Cdn $)* | 6.2 | 40.5 |
| **Canadian Bond Market** | | |
| *SC Bond Universe Index* | 5.0 | 10.8 |

## FUND VALUE AND TRANSFERS TO THE GENERAL REVENUE FUND

At March 31, 2005, the fair value of the Heritage Fund totalled $12.2 billion. Since 1976 total transfers to the GRF have increased to approximately $27.6 billion.

### FUND VALUE AND TRANSFERS TO THE GENERAL REVENUE FUND

(billions)




## CHANGE IN FAIR VALUE OF FUND

The Heritage Fund accounts for its investments and investment income on a cost basis of accounting, which excludes unrealized gains and losses. Investments and investment income on a fair value basis includes unrealized gains and losses. The investment income on a fair value basis for fiscal year 2004-05 is $918 million (2003-04: $2,454 million).

### CHANGES IN NET ASSETS

(millions)

| | 2005 | 2004 |
|---|---|---|
| Fair value, beginning of year | $ 12,396 | $11,075 |
| Investment income, cost basis* | 1,092 | 1,133 |
| Change in unrealized appreciation (depreciation) in value of investments | (174) | 1,321 |
| Investment income, fair value basis | 918 | 2,454 |
| Transfers to the General Revenue Fund** | (1,092) | (1,133) |
| Fair value, end of year*** | $ 12,222 | $12,396 |

* includes interest, dividends, realized gains and losses, derivative income and administration expenses

** see financial statements (Note 6)

*** includes investments of $12,277 million less net current liabilities of $55 million.

## INVESTMENT INCOME

The Fund recorded net income of $1,092 million during fiscal year 2004-05 compared to $1,133 million in the previous year. Of the total income earned during the year, $424 million came from interest, dividends, real estate income and security lending income, net of administrative fees and $668 million came from net realized gains from sale of securities and gains and losses from derivative transactions.

### NET INVESTMENT INCOME (LOSS)

(millions)

| | Fixed Income | Equity Income | Real Estate | Absolute Return Strategies | Total |
|---|---|---|---|---|---|
| 04-05 | $ 264 | $ 728 | $ 68 | $ 32 | $ 1,092 |
| 03-04 | 304 | 737 | 54 | 38 | 1,133 |
| 02-03 | 286 | (1,224) | 39 | 5 | (894) |
| 01-02 | 444 | (276) | 38 | - | 206 |
| 00-01 | 532 | 157 | 17 | - | 706 |

## TRANSFERS TO THE GENERAL REVENUE FUND

Net investment income earned by the Heritage Fund is not reinvested. Instead, all of the net income is transferred to the Province's General Revenue Fund (GRF). Unrealized gains and losses are not included in amounts transferred to the GRF.

The Fund's net income for the year ended March 31, 2005, amounted to $1,092 million of which $1,030 million was transferred to the GRF and $62 million remains payable to GRF.

The Government of Alberta financial statements are prepared on a consolidated basis, which eliminates the income the Heritage Fund earns from Alberta provincial corporation securities totaling $16 million for the year ending March 31, 2005. On a consolidated basis the Heritage Fund net income was $1,076 million.

## INVESTMENT VALUATION

Investments and investment income are recorded on the financial statements of the Heritage Fund at cost in accordance with government accounting policies. The fair value of the Fund and its investments are provided for information purposes. Management uses fair value to assess the investment performance of the fund against market-based benchmarks.

The Fund's policy is to write down the cost of those securities where the decline in value below cost is not considered temporary. On a quarterly basis, management reviews the Fund's investment portfolio to identify those securities where the fair value has declined significantly below cost. The Fund's net income for fiscal 2004-05 includes writedowns, primarily to public equities, totalling $34.4 million (2003-04 $2.6 million).

### ASSET MIX POLICY

Percent of Fair Value

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | Policy Target | Actual | Policy Target | Actual |
| **ASSET CLASS** | | | | |
| **Fixed income** | 32.5 | 32.7 | 35.0 | 33.2 |
| **Equities** | | | | |
| Public equities: | | | | |
| Canadian | 15.0 | 18.5 | 15.0 | 22.1 |
| United States | 15.0 | 16.2 | 15.0 | 15.6 |
| Non-north American | 15.0 | 16.1 | 15.0 | 16.4 |
| | 45.0 | 50.8 | 45.0 | 54.1 |
| **Real Estate** | 10.0 | 9.7 | 10.0 | 7.6 |
| **Absolute Return Strategies** | 7.5 | 5.0 | 5.0 | 4.0 |
| **Private equities and income** | 5.0 | 1.8 | 5.0 | 1.1 |
| | 100.0 | 100.0 | 100.0 | 100.0 |

## INVESTMENTS

### Asset Mix

The investment strategy is to invest in a diversified portfolio to optimize long-term returns at an acceptable level of risk. The policy asset allocation is reported in the Fund's 2004-07 business plan as follows:

Based on the Heritage Fund 2004-07 business plan, the long term policy asset mix for fixed income securities decreases from 35.0% to 32.5%. The long-term policy mix for public equity investments remains the same at 45.0%. The reduction in Canadian fixed income securities is offset by an increase in absolute return strategy investments. Absolute return strategy investments increase from 5.0% to 7.5% of total portfolio investments. The target for real estate investments is expected to remain unchanged at 10.0% of total portfolio investments.

The actual investment mix for fixed income securities decreased slightly to 32.7% from 33.2% at the beginning of the year. Public equity investments decreased to 50.8% from 54.1%. Real estate investments increased to 9.7% from 7.6% of the Fund's total investment portfolio. Absolute return strategies increased to 5.0% from 4.0% of the Fund's investment portfolio. Private equity and income investments increased to 1.8% from 1.1%.

### New Investment Products

Over the year, a number of new investment products have been introduced in order to further diversify the Heritage Fund's investment portfolio (see Note 3 to the financial statements). In particular the Fund reduced its investment in U.S. large cap equities and purchased U.S. portable alpha investments, which blend absolute return strategies within a portfolio of derivatives such as equity swaps and futures. In the non-North American sector, the Fund added investments in emerging markets. The Fund also redeemed its entire investment in Canadian small cap equities and increased its investment in Canadian and foreign private equities and real estate. During the year, the Fund restructured its actively managed Canadian large cap equity portfolio using enhanced index and multi-cap products. The Canadian enhanced index product generates a consistent level of return above the S&P/TSX Index with relatively low risk. The Canadian multi-cap product blends both internally managed structured investments replicating the S&P/TSX 60 Index with externally managed equity investments in small and mid capitalized companies. The Fund also implemented an investment overlay strategy, which uses exchange-traded futures to obtain exposure to a particular asset class on a largely unfunded basis.

# Performance Measurement

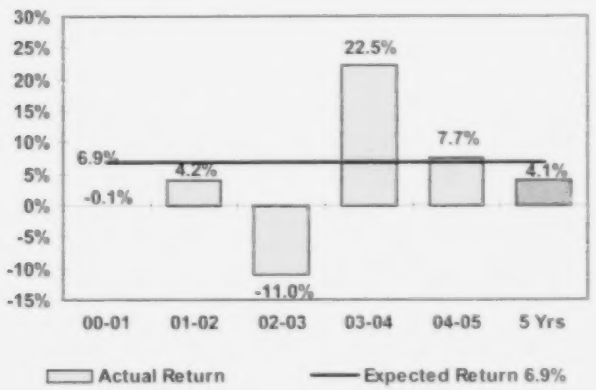
## HERITAGE FUND RATE OF RETURN

The Heritage Fund posted an overall rate of return of 7.7% this year, 130 basis points better than the Fund's benchmark return of 6.4%. The Fund earned positive returns from all asset classes.

The performance of the Heritage Fund is measured over the long term. Over the past five-year period, the fund generated a nominal annualized return of 4.1%. The Heritage Fund is expected to generate a real rate of return of 4.5% at an acceptable level of risk over a moving five-year period. Over a five-year period, the annualized inflation rate was 2.4%. Therefore, the Fund was expected to generate a nominal annualized rate of return of 6.9%. Over the past five years, returns from world equity markets have under-performed historical long-term average rates of return.

### HERITAGE FUND ANNUAL RETURNS

At Fair Value (percent)




The performance of the Heritage Fund investments is measured against various market-based indices. Value added by investment management is accomplished through asset mix decisions and security selection. The following sections describe the performance of the Fund's major asset classes in relation to their benchmarks.

## BUSINESS PLAN PERFORMANCE MEASURES

### HERITAGE FUND (COMBINED) (1)

| | 2005 | Five Years(2) |
|---|---|---|
| Total fund return (%) | 7.7 | 4.1 |
| **ENDOWMENT PORTFOLIO** | | |
| Actual return (%) | 7.7 | 2.6 |
| Benchmark return (%) | 6.4 | 2.1 |
| Over benchmark | 1.3 | 0.5 |
| **Actual Return** *(by asset class)* | | |
| ST fixed income | 2.3 | 3.5 |
| LT fixed income | 5.5 | 8.4 |
| Canadian public equities | 15.4 | 2.9 |
| US public equities | (1.6) | (6.3) |
| EAFE public equities | 7.6 | (4.8) |
| Real Estate | 17.0 | 10.2 |
| Absolute Return Strategies | 5.5 | n/a |
| Private equities | 5.2 | n/a |
| Private income | 5.3 | n/a |
| **Benchmark Return** *(by asset class)* | | |
| ST fixed income | 2.2 | 3.5 |
| LT fixed income | 5.0 | 7.7 |
| Canadian equities | 13.9 | 2.0 |
| US equities | (1.0) | (6.5) |
| EAFE equities | 6.2 | (4.7) |
| Real estate | 7.1 | 8.8 |
| Absolute return strategies | 8.1 | n/a |
| Private equities | 10.1 | n/a |
| Private income | 8.1 | n/a |

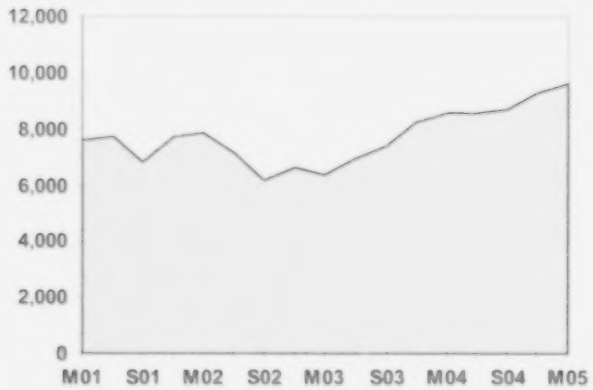
(1) The Transition Portfolio was wound up in the first half of 2002-03. The combined Heritage return includes the past performance of the Transition Portfolio.

(2) Annualized

## FIXED INCOME INVESTMENTS

The Scotia Capital (SC) Universe Bond Index measures the performance of marketable Canadian bonds with terms to maturity of more than one year. Over the past year, the SC Universe Bond Index increased by 5.0% while the short term SC 91-Day T-Bill Index increased by 2.2%.

### SC UNIVERSE BOND INDEX




| LT Fixed Income | Actual Return % | Benchmark SC Universe Bond Index % | Over (Under) bps* |
|---|---|---|---|
| One Year | 5.5 | 5.0 | 50 |
| Five Years (annualized) | 8.4 | 7.7 | 70 |

| ST Fixed Income | Actual Return % | Benchmark SC 91-Day T-Bill Index % | Over (Under) bps* |
|---|---|---|---|
| One Year | 2.3 | 2.2 | 10 |
| Five Years (annualized) | 3.5 | 3.5 | - |

* one basis point equals 0.01%

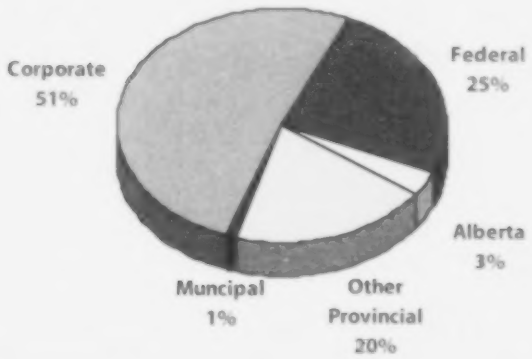
The Fund's actual rate of return over the year from long-term Canadian fixed income securities was 5.5%, 50 basis points better than the benchmark SC Universe Bond Index. Over five years, the return from long-term fixed income securities was 8.4% or 70 basis points better than the benchmark of 7.7%. The Fund's return from short-term securities was 2.3% and 3.5% over one year and five years respectively. The Heritage Fund's fixed income portfolio is internally managed through various pools and through direct holdings.

At March 31, 2005, investments in deposits, bonds, notes, short-term paper, provincial corporation debentures and loans totalled 32.7% of total portfolio investments or $4.0 billion down from 33.2% or $4.2 billion at March 31, 2004.

The Fund's Canadian fixed-income portfolio is comprised of diversified holdings in corporate, federal, provincial and municipal bonds, notes and short-term paper.

### SUMMARY OF FIXED INCOME HOLDINGS

(issued and guaranteed by)




## CANADIAN EQUITY INVESTMENTS

The Canadian stock market finished the year on a positive note. The Toronto Stock Exchange S&P/TSX Index, which measures the performance of Canada's top companies, reported a return of 13.9% for the year ending March 31, 2005. During the year, the energy and telecommunications sectors led all sectors with returns of 43.6% and 23.6% respectively. The healthcare sector finished the year with the lowest return of negative 25.3%.

### S&P / TSX INDEX

| Canadian Public Equities | Actual Return % | Benchmark S&P/TSX Index % | Over (Under) bps |
|---|---|---|---|
| One Year | 15.4 | 13.9 | 150 |
| Five Years (annualized) | 2.9 | 2.0 | 90 |

The Heritage Fund's Canadian equity portfolio is held in various investment pools, which are managed by internal and external managers. Over the year the Fund's actual return from Canadian equities rose by 15.4%, 150 basis points better than the benchmark S&P/TSX Composite Index of 13.9%. Over five years, the Fund's return from Canadian equities was 2.9% compared to the benchmark return of 2.0%.

At March 31, 2005, investments in Canadian public equities totalled 18.5% or $2.3 billion of the Heritage Fund investment portfolio compared to 22.1% or $2.8 billion one year earlier.

### CANADIAN PUBLIC EQUITIES

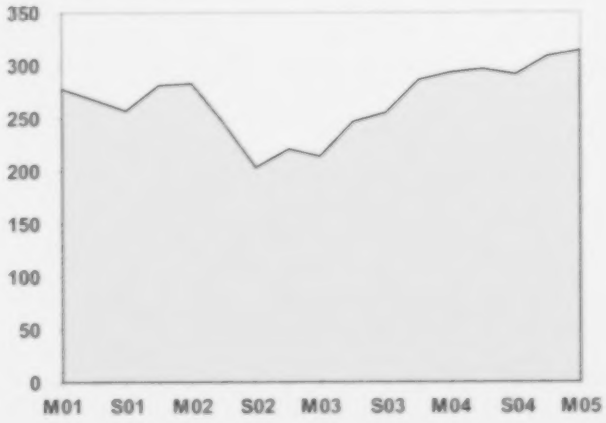
(By Industry Sector)

| | 2005 % | 2004 % |
|---|---|---|
| Financials | 33 | 33 |
| Energy | 21 | 15 |
| Materials | 15 | 16 |
| Consumer discretionary | 7 | 7 |
| Industrials | 6 | 8 |
| Information technology | 6 | 7 |
| Telecommunications | 6 | 5 |
| Consumer staples | 4 | 4 |
| Health Care | 1 | 2 |
| Utilities | 1 | 3 |
| Total | 100 | 100 |

## UNITED STATES EQUITY INVESTMENTS

The U.S. equity market closed out the year posting a positive return in US dollars. The Standard & Poor's 1500 Index, S&P 1500, which measures the performance of the top 1500 American companies, rose by 7.2% in US dollars and negative 1.0% in Canadian dollars.

### S&P 1500 INDEX




| US Public Equities | Actual Return % | Benchmark S&P 1500 Index* % | Over (Under) bps |
|---|---|---|---|
| One Year | (1.6) | (1.0) | (60) |
| Five Years (annualized) | (6.3) | (6.5) | 20 |

*Effective April 1, 2004, the benchmark return for US equities changed to the S&P 1500 Index from the S&P 500 Index. The S&P 1500 Index provides a broader coverage of US equities to include smaller capitalization stocks. The S&P 1500 Index covers approximately 90% of US publicity traded equities.

The Fund's actual rate of return over the year from US equities was negative 1.6% in Canadian dollars or 60 basis points less than the S&P 1500 Index. Over five years, the Fund's US equity portfolio returned a negative 6.3%, 20 basis points better than the benchmark.

At March 31, 2005, investments in US equities totalled 16.2% or $2.0 billion of the Heritage Fund investment portfolio compared to 15.6% or $2.0 billion at March 31, 2004.

### UNITED STATES PUBLIC EQUITIES

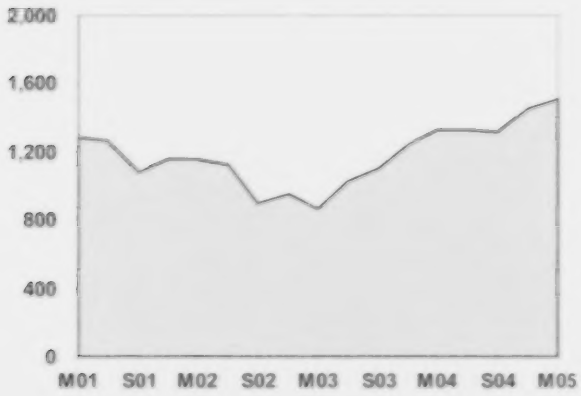
(By Industry Sector)

| | 2005 % | 2004 % |
|---|---|---|
| Financials | 20 | 21 |
| Information technology | 15 | 16 |
| Health Care | 13 | 12 |
| Consumer discretionary | 12 | 16 |
| Industrials | 12 | 11 |
| Consumer staples | 9 | 9 |
| Energy | 9 | 6 |
| Materials | 4 | 4 |
| Telecommunications | 3 | 3 |
| Utilities | 3 | 2 |
| Total | 100 | 100 |

## NON-NORTH AMERICAN EQUITY INVESTMENTS

The non-North American equity market recorded an overall positive return this year. The Morgan Stanley Capital International Index for Europe, Australasia, and the Far East, MSCI EAFE Index, measures the performance of approximately 1000 companies on 21 stock exchanges around the world. The index increased by 6.2% over the year, in Canadian dollars.

### MSCI EAFE INDEX




| EAFE Public Equities | Actual Return % | Benchmark MSCI EAFE Index % | Over (Under) bps |
|---|---|---|---|
| One Year | 7.6 | 6.2 | 140 |
| Five Years (annualized) | (4.8) | (4.7) | (10) |

The Fund's actual return from non-North American equities was 7.6%, 140 basis points better than the benchmark MSCI EAFE Index. Over five years the Fund's non-North American equity portfolio returned a negative 4.8%, 10 basis points less than the benchmark MSCI EAFE Index.

At March 31, 2005, investments in non-North American equities totalled 16.1% or $2.0 billion of the Heritage Fund investment portfolio compared to 16.4% or $2.1 billion at March 31, 2004.

### NON-NORTH AMERICAN PUBLIC EQUITIES

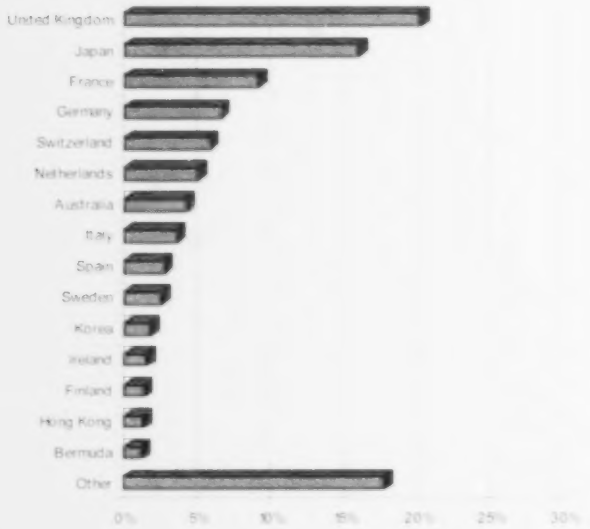
(By Industry Sector)

| | 2005 % | 2004 % |
|---|---|---|
| Financials | 27 | 24 |
| Consumer discretionary | 14 | 16 |
| Industrials | 12 | 11 |
| Energy | 9 | 8 |
| Materials | 9 | 8 |
| Telecommunications | 8 | 8 |
| Consumer staples | 6 | 7 |
| Health Care | 6 | 8 |
| Information technology | 5 | 6 |
| Utilities | 4 | 4 |
| Total | 100 | 100 |

The Fund's Non-North American equity portfolio is invested through out the world.

### NON-NORTH AMERICAN EQUITIES BY COUNTRY

Percent of Fair Value



## REAL ESTATE INVESTMENTS

The Fund's real estate investments are held in the internally managed Private Real Estate Pool and in the newly created Foreign Private Real Estate Pool. Real estate investments earned 17.0% over the year and 10.2% over five years. The outperformance over one year was due to strong returns from the portfolio's retail assets.

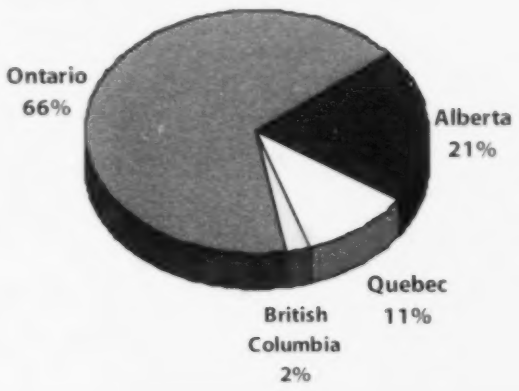
| Real estate | Actual Return % | Benchmark CPI plus 5%* % | Over (Under) bps |
|---|---|---|---|
| One Year | 17.0 | 7.1 | 990 |
| Five Years (annualized) | 10.2 | 8.8 | 140 |

* Effective April 1, 2002, the benchmark changed from the Russell Canadian Property Index (RCPI) to CPI plus 5%. Therefore, the benchmark for five years is a combination of RCPI and CPI plus 5%.

Nearly half of the real estate portfolio is invested in retail, half in office and a small portion in industrial and residential. Approximately 66% of the real estate holdings are located in Ontario, 21% in Alberta, 11% in Quebec and 2% in British Columbia.

At March 31, 2005, investments in real estate totalled 9.7% or $1.2 billion of the Heritage Fund investment portfolio compared to 7.6% or $950 million at March 31, 2005.

### REAL ESTATE BY GEOGRAPHIC DISTRIBUTION




## ABSOLUTE RETURN STRATEGIES

Absolute return strategy investments encompass a wide variety of investments with the objective of realizing positive returns regardless of the overall market direction. A common feature of many of these strategies is buying undervalued securities and selling short overvalued securities. Over the year absolute return strategies generated a positive return of 5.5%, 260 basis points less than the benchmark Consumer Price Index (CPI) plus 6.0%.

| Absolute Return Strategies | Actual Return % | Benchmark CPI plus 6% % | Over (Under) bps |
|---|---|---|---|
| One year | 5.5 | 8.1 | (260) |
| Five Years (annualized) | n/a | n/a | - |

At March 31, 2005, investments in absolute return strategies totalled 5.0% or $611 million of total Fund investments compared to 4.0% or $507 million at March 31, 2004.

## PRIVATE EQUITY AND INCOME INVESTMENTS

At March 31, 2005, the private equity and private income portfolio comprised a small portion of the Fund's overall investment portfolio at 1.8% or $214 million compared to 1.1% or $136 million at March 31, 2004.

During the year, the private equity and private income portfolios returned 5.2% and 5.3% respectively compared to their benchmark returns of 10.1% and 8.1% respectively. Investments in the early stages of development are expected to have lower returns due to higher initial management fees and start-up costs.

| Private Equity | Actual Return % | Benchmark CPI plus 8% % | Over (Under) bps |
|---|---|---|---|
| One Year | 5.2 | 10.1 | (490) |
| Five Years (annualized) | n/a | n/a | - |

| Private Income | Actual Return % | Benchmark CPI plus 6% % | Over (Under) bps |
|---|---|---|---|
| One Year | 5.3 | 8.1 | (280) |
| Five Years (annualized) | n/a | n/a | - |

# Administrative Expenses

Administrative expenses include expenses incurred to manage the Fund's investment portfolio. Fees charged by external managers are deducted directly from the income of externally managed investment pools. Internal investment management costs are deducted from the internally managed pooled funds and also directly from the Fund. External investment management fees are based on a percentage of net assets under management at fair value. Internal investment management expenses are based on a cost recovery basis.

The Fund's total administrative expenses for the year ended March 31, 2005, including amounts deducted from the investment income of the pooled funds, amounted to $20,708,000 or 0.169% of the Funds net assets at fair value compared to $17,929,000 or 0.145% the previous year.

**ADMINISTRATIVE EXPENSE BREAKDOWN**

Year ended March 31, 2005

| | 2005 | 2004 |
|---|---|---|
| | *(thousands)* | |
| Direct fund expenses | $ 2,203 | $ 2,166 |
| Externally managed investment pools | 14,792 | 12,338 |
| Internally managed investment pools | 3,713 | 3,425 |
| Total | $ 20,708 | $ 17,929 |
| Expenses as a percent of net assets at fair value | 0.169% | 0.145% |

The Fund's direct investment expenses and allocation from internally managed investment pools increased by $325,000 compared to last year. The Fund's allocation of expenses from externally managed investment pools increased by $2,454,000 compared to last year. Increases in external management fees and assets under management for non-North American equities contributed to the increase in externally managed fees.

Approximately 80% of total administrative expenses relate to investment management and 20% relate to administration.

## HISTORICAL SUMMARY OF OPERATIONS

May 19, 1976 to March 31, 2005

*(millions)*

| | Net Income (loss) | Transfers From GRF | Transfers To GRF (a) | Fund Equity (b) |
|---|---|---|---|---|
| **1976-77** | $ 88 | $ 2,120 | $ (36) | $ 2,172 |
| **1977-78** | 194 | 931 | (87) | 3,210 |
| **1978-79** | 294 | 1,059 | (132) | 4,431 |
| **1979-80** | 343 | 1,332 | (478) | 5,628 |
| **1980-81** | 724 | 1,445 | (227) | 7,570 |
| **1981-82** | 1,007 | 1,433 | (349) | 9,661 |
| **1982-83** | 1,482 | 1,370 | (1,162) | 11,351 |
| **1983-84** | 1,467 | 720 | (1,799) | 11,739 |
| **1984-85** | 1,575 | 736 | (1,803) | 12,247 |
| **1985-86** | 1,667 | 685 | (1,907) | 12,692 |
| **1986-87** | 1,445 | 216 | (1,672) | 12,681 |
| **1987-88** | 1,353 | - | (1,482) | 12,552 |
| **1988-89** | 1,252 | - | (1,407) | 12,397 |
| **1989-90** | 1,244 | - | (1,378) | 12,263 |
| **1990-91** | 1,337 | - | (1,487) | 12,113 |
| **1991-92** | 1,382 | - | (1,466) | 12,029 |
| **1992-93** | 785 | - | (869) | 11,945 |
| **1993-94** | 1,103 | - | (1,174) | 11,874 |
| **1994-95** | 914 | - | (963) | 11,825 |
| **1995-96** | 1,046 | - | (1,046) | 11,825 |
| **1996-97** | 932 | - | (756) | 12,001 |
| **1997-98** | 947 | - | (922) | 12,026 |
| **1998-99** | 932 | - | (932) | 12,026 |
| **1999-00** | 1,169 | - | (939) | 12,256 |
| **2000-01** | 706 | - | (706) | 12,256 |
| **2001-02** | 206 | - | (206) | 12,256 |
| **2002-03** | (894) | - | - | 11,362 |
| **2003-04** | 1,133 | - | (1,133) | 11,362 |
| **2004-05** | 1,092 | - | (1,092) | 11,362 |
| **TOTAL** | **$ 26,925** | **$ 12,047** | **$ (27,610)** | **$ 11,362** |

(a) includes transfers for capital projects during 1976 to 1995.

(b) at cost

FINANCIAL STATEMENTS

MARCH 31, 2005

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# Auditor's Report

**TO THE MINISTER OF FINANCE**

I have audited the balance sheet of the Alberta Heritage Savings Trust Fund as at March 31, 2005 and the statements of operations and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

FCA
Auditor General

Edmonton, Alberta
May 20, 2005

# FINANCIAL STATEMENTS

## BALANCE SHEET

***March 31, 2005 (thousands)***

| | 2005 | 2004 |
|---|---|---|
| **Assets** | | |
| Portfolio investments (Note 3) | $ 11,417,548 | $ 11,507,117 |
| Accrued investment income | 7,008 | 7,542 |
| Administrative expense receivable | 281 | 310 |
| | $ 11,424,837 | $ 11,514,969 |
| **Liabilities and Fund Equity** | | |
| Liabilities | | |
| Accounts payable | $ 7 | $ 42 |
| Due to the General Revenue Fund | 62,388 | 152,485 |
| | 62,395 | 152,527 |
| Fund equity (Note 6) | 11,362,442 | 11,362,442 |
| | $ 11,424,837 | $ 11,514,969 |

## STATEMENT OF OPERATIONS

***Year Ended March 31, 2005 (thousands)***

| | 2005 | | 2004 |
|---|---|---|---|
| | Budget | Actual | Actual |
| Net income (Note 7) | $ 644,241 | $ 1,091,903 | $ 1,133,485 |
| Transfers to the General Revenue Fund (Note 6) | 644,241 | 1,091,903 | 1,133,485 |
| Net change in fund equity (Note 6) | $ – | – | – |
| Fund equity at beginning of year | | 11,362,442 | 11,362,442 |
| Fund equity at end of year | | $ 11,362,442 | $ 11,362,442 |

The accompanying notes and schedules are part of these financial statements.

# FINANCIAL STATEMENTS

## STATEMENT OF CASH FLOWS

***Year Ended March 31, 2005 (thousands)***

| | 2005 | 2004 |
|---|---|---|
| **Operating transactions** | | |
| Net income | $ 1,091,903 | $ 1,133,485 |
| Non-cash items included in net income | (208,924) | (166,266) |
| | 882,979 | 967,219 |
| Decrease in accounts receivable | 563 | 8,295 |
| Increase (decrease) in accounts payable | (35) | 42 |
| Cash provided by operating transactions | 883,507 | 975,556 |
| **Investing transactions** | | |
| Proceeds from disposals, repayments and redemptions of investments | 2,716,273 | 1,576,492 |
| Purchase of investments | (2,460,083) | (1,707,900) |
| Cash provided by (applied to) investing transactions | 256,190 | (131,408) |
| **Transfers** | | |
| Transfers to the General Revenue Fund | (1,091,903) | (1,133,485) |
| Increase (decrease) in amounts due to the General Revenue Fund | (90,097) | 152,485 |
| Cash applied to transfers | (1,182,000) | (981,000) |
| **Decrease in cash** | (42,303) | (136,852) |
| **Cash at beginning of year** | 113,662 | 250,514 |
| **Cash at end of year** | $ 71,359 | $ 113,662 |
| **Consisting of Deposit in the Consolidated Cash Investment Trust Fund (Note 3)** | $ 71,359 | $ 113,662 |

The accompanying notes and schedules are part of these financial statements.

# FINANCIAL STATEMENTS

## NOTES TO THE FINANCIAL STATEMENTS
***March 31, 2005 (in thousands)***

### NOTE 1 AUTHORITY AND MISSION

The Alberta Heritage Savings Trust Fund ("the Fund") operates under the authority of the *Alberta Heritage Savings Trust Fund Act* (the Act), Chapter A-23, Revised Statutes of Alberta 2000, as amended.

The preamble to the Act describes the mission of the Fund as follows:

*"To provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans."*

### NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

The recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants are the primary source for the disclosed basis of accounting. Recommendations of the Accounting Standards Board of the Canadian Institute of Chartered Accountants, other authoritative pronouncements, accounting literature, published financial statements relating to either the public sector or analogous situations in the private sector are used to supplement the recommendations of the Public Sector Accounting Board where it is considered appropriate.

The accounting policies of significance to the Fund are as follows:

**(a) Portfolio Investments**

Fixed-income securities, mortgages, equities, real estate investments and absolute return strategy investments held directly by the Fund or by pooled investment funds are recorded at cost. Cost includes the amount of applicable amortization of discount or premium using the straight-line method over the life of the investments.

Investments in loans are recorded at cost less any allowance for credit loss. Where there is no longer reasonable assurance of timely collection of the full amount of principal and interest of a loan, a specific provision for credit loss is made and the carrying amount of the loan is reduced to its estimated realizable amount.

Investments are recorded as of the trade date.

The cost of disposals is determined on the average cost basis.

Where there has been a loss in value of an investment in fixed-income securities, mortgages, equities, real estate and absolute return strategies that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost.

**(b) Investment Income**

Investment income is recorded on the accrual basis where there is reasonable assurance as to its measurement and collectability. When a loan becomes impaired, recognition of interest income in accordance with the terms of the original loan agreement ceases. Any subsequent payments received on an impaired loan are applied to reduce the loan's book value.

Gains and losses arising as a result of disposals of investments are included in the determination of investment income.

Income and expense from derivative contracts are included in investment income. Certain derivative contracts, which are primarily interest rate swaps and cross-currency interest rate swaps, are designated as hedges of market risks for purposes of hedge accounting. Hedge accounting recognizes gains and losses from derivatives in the statement of income in the same period as the gains and losses of the security being hedged. As a result, income and expense from derivative contracts designated as hedges are recognized in income on an accrual basis with gains and losses recognized in income to the extent realized.

Where a hedge relationship is designated, the hedge is documented at inception. The documentation

## FINANCIAL STATEMENTS

Note 2 (continued)

identifies the specific asset being hedged, the risk that is being hedged, type of derivative used and the matching of critical terms of both the hedged security and the hedging derivative for purposes of measuring effectiveness. The derivative must be highly effective in accomplishing the objective of offsetting either changes in the fair value or cash flows attributable to the risk being hedged both at inception and over the life of the hedge.

Derivative contracts not designated as hedges for purposes of hedge accounting, which are primarily bond index swaps, equity index swaps, equity index futures, forward foreign exchange contracts and credit default swap contracts are recorded at fair value.

**(c) Foreign Currency**

Foreign currency transactions are translated into Canadian dollars using average rates of exchange; except for hedged foreign currency transactions, which are translated at rates of exchange established by the terms of the forward exchange contracts. Exchange differences on unhedged transactions are included in the determination of investment income.

**(d) Investment Valuation**

Portfolio investments are recorded in the financial statements at cost. The fair value of investments is provided for information purposes and is disclosed in Note 3 and Schedules A to E.

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Measurement uncertainty exists in the fair values reported for certain investments such as private equities; private real estate, loans, absolute return strategies and other private placements. The fair values of these investments are based on estimates where quoted market prices are not readily available. Estimated fair values may not reflect amounts that could be realized upon immediate sale, nor amounts that ultimately may be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments.

Fair value of investments held either directly by the Fund or by pooled investment funds are determined as follows:

(i) Public fixed-income securities and equities are valued at the period-end closing sale price, or the average of the latest bid and ask prices quoted by an independent securities valuation company.

(ii) Mortgages, provincial corporation debentures and private fixed-income securities are valued based on the net present value of future cash flows. These cash flows are discounted using appropriate interest rate premiums over similar Government of Canada benchmark bonds trading in the market.

(iii) The fair value of private equities is estimated by managers or general partners of private equity funds, pools and limited partnerships. Valuation methods may encompass a broad range of approaches. The cost approach is used to value companies without either profits or cash flows. Established private companies are valued using the fair market value approach reflecting conventional valuation methods including discounted cash flows and multiple analysis.

(iv) The fair value of real estate investments is reported at the most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers. Appraisers use a combination of approaches to determine fair value including replacement cost, direct comparison, direct capitalization of earnings and the discounted cash flows.

Note 2 (continued)

(v) The fair value of Absolute Return Strategy Pool investments are estimated by external managers.

(vi) The fair value of loans is estimated by management based on the present value of discounted cash flows.

(vii) The fair value of deposits, receivables, accrued interest and payables are estimated to approximate their book values.

(viii) The fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate.

**(e) Valuation of Derivative Contracts**

Derivative contracts include equity and bond index swaps, interest rate swaps, cross-currency interest rate swaps, credit default swaps, forward foreign exchange contracts and equity index futures contracts. As disclosed in Note 4, the value of derivative contracts is included in the fair value of pooled investment funds. The estimated fair value of derivative contracts at the reporting date is determined by the following methods:

(i) Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.

(ii) Interest rate swaps and cross-currency interest rate swaps are valued based on discounted cash flows using current market yields and exchange rates.

(iii) Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.

(iv) Forward foreign exchange contracts and equity index futures contracts are valued based on quoted market prices.

# FINANCIAL STATEMENTS

## NOTE 3 PORTFOLIO INVESTMENTS

| | 2005 | | | 2004 | | |
|---|---|---|---|---|---|---|
| | Cost | Fair Value | % | Cost | Fair Value | % |
| | *(thousands)* | | | *(thousands)* | | |
| **Fixed Income Securities (Schedule A)** | | | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 71,359 | $ 71,359 | 0.6 | $ 113,662 | $ 113,662 | 0.9 |
| Canadian Dollar Public Bond Pool (b) | 3,094,268 | 3,154,021 | 25.5 | 3,135,075 | 3,223,579 | 25.7 |
| Bonds, notes & short-term paper, directly held (c) | 23,067 | 23,742 | 0.2 | 23,799 | 25,304 | 0.2 |
| Private Mortgage Pool (d) | 518,924 | 532,357 | 4.3 | 544,000 | 558,409 | 4.5 |
| Provincial corporation debentures, directly held (e) | 88,340 | 132,261 | 1.1 | 94,656 | 150,125 | 1.2 |
| Loans, directly held (f) | 93,298 | 93,298 | 0.8 | 93,144 | 93,144 | 0.7 |
| Overlay Pool (g) | 24,529 | 24,555 | 0.2 | - | - | - |
| | **3,913,785** | **4,031,593** | **32.7** | **4,004,336** | **4,164,223** | **33.2** |
| **Public Equities** | | | | | | |
| **Canadian (Schedule B)** | | | | | | |
| Domestic Passive Equity Pooled Fund (h) | 868,241 | 989,240 | 8.1 | 989,162 | 1,152,226 | 9.2 |
| Canadian Pooled Equity Fund (i) | 491,455 | 605,425 | 4.9 | 581,354 | 699,381 | 5.6 |
| External Managers: | | | | | | |
| Canadian Equity Enhanced Index Pool (j) | 292,113 | 319,695 | 2.6 | - | - | - |
| Canadian Large Cap Equity Pool (k) | 163,796 | 184,242 | 1.5 | 576,697 | 674,266 | 5.4 |
| Canadian Small Cap Equity Pool | - | - | - | 36,611 | 51,135 | 0.4 |
| Growing Equity Income Pool (l) | 128,558 | 152,821 | 1.3 | 182,284 | 191,135 | 1.5 |
| Canadian Multi-Cap Pool (m) | 138,847 | 138,958 | 1.1 | - | - | - |
| | 2,083,010 | 2,390,381 | 19.5 | 2,366,108 | 2,768,143 | 22.1 |
| Overlay Pool Canadian futures contracts (g) | (125,308) | (125,308) | (1.0) | - | - | - |
| | **1,957,702** | **2,265,073** | **18.5** | **2,366,108** | **2,768,143** | **22.1** |
| **United States (Schedule C)** | | | | | | |
| S&P 500 Index Fund (n) | 1,179,505 | 1,284,273 | 10.4 | 914,333 | 1,031,374 | 8.2 |
| External Managers: | | | | | | |
| US Small/Mid Cap Equity Pool (o) | 237,574 | 240,550 | 2.0 | 224,758 | 244,619 | 1.9 |
| US Large Cap Equity Pool | 77 | 77 | - | 687,476 | 685,839 | 5.5 |
| Portable Alpha US Equity Pool (p) | 326,700 | 316,340 | 2.6 | - | - | - |
| Growing Equity Income Pool (l) | 24,513 | 24,350 | 0.2 | - | - | - |
| | 1,768,369 | 1,865,590 | 15.2 | 1,826,567 | 1,961,832 | 15.6 |
| Overlay Pool US futures contracts (g) | 125,969 | 125,969 | 1.0 | - | - | - |
| | **1,894,338** | **1,991,559** | **16.2** | **1,826,567** | **1,961,832** | **15.6** |
| **Non-North American (Schedule D)** | | | | | | |
| External Managers: | | | | | | |
| EAFE Core Equity Pool (q) | 926,654 | 977,096 | 8.0 | 949,210 | 1,027,313 | 8.2 |
| EAFE Plus Equity Pool (q) | 475,764 | 490,505 | 4.0 | 460,474 | 500,339 | 4.0 |
| EAFE Passive Equity Pool (r) | 267,922 | 364,905 | 3.0 | 366,816 | 525,190 | 4.2 |
| Emerging Markets Equity Pool (s) | 128,567 | 141,465 | 1.1 | - | - | - |
| | **1,798,907** | **1,973,971** | **16.1** | **1,776,500** | **2,052,842** | **16.4** |
| **Real Estate (Schedule E)** | | | | | | |
| Private Real Estate Pool (t) | 966,041 | 1,148,626 | 9.4 | 871,959 | 949,771 | 7.6 |
| Foreign Private Real Estate Pool (u) | 43,161 | 40,948 | 0.3 | - | - | - |
| | **1,009,202** | **1,189,574** | **9.7** | **871,959** | **949,771** | **7.6** |
| **Absolute Return Strategies** | | | | | | |
| External Managers Absolute Return Strategy Pool (v) | **615,053** | **610,593** | **5.0** | **512,075** | **507,721** | **4.0** |
| **Private Equities (w)** | | | | | | |
| Private Equity Pools | 166,624 | 153,374 | 1.3 | 135,934 | 122,734 | 1.0 |
| Private Income Pools | 61,937 | 61,012 | 0.5 | 13,638 | 13,624 | 0.1 |
| | **228,561** | **214,386** | **1.8** | **149,572** | **136,358** | **1.1** |
| **Total Investments (x)** | **$ 11,417,548** | **$ 12,276,749** | **100.0** | **$ 11,507,117** | **$ 12,540,890** | **100.0** |

# FINANCIAL STATEMENTS

Note 3 (continued)

The majority of the Fund's investments are held in pooled investment funds established and administered by Alberta Finance. Pooled investment funds have a market based unit value that is used to allocate income to participants and to value purchases and sales of pool units. As at March 31, 2005, the Fund's percentage ownership, at market, in pooled investment funds is as follows:

| | % Ownership | |
|---|---|---|
| | 2005 | 2004 |
| **Internally Managed Investment Pools** | | |
| Canadian Dollar Public Bond Pool | 35.6 | 38.3 |
| Canadian Multi-Cap Pool | 60.2 | – |
| Canadian Pooled Equity Fund | 56.3 | 67.8 |
| Domestic Passive Equity Pooled Fund | 41.7 | 49.2 |
| Foreign Private Equity Pool (02) | 43.8 | 43.8 |
| Foreign Private Real Estate Pool | 87.1 | – |
| Growing Equity Income Pool | 59.1 | 75.3 |
| Overlay Pool | 35.5 | – |
| Private Equity Pool | 13.6 | 13.6 |
| Private Equity Pool (98) | 100.0 | 100.0 |
| Private Equity Pool (02) | 62.1 | 62.1 |
| Private Equity Pool (04) | 77.0 | – |
| Private Income Pool | 25.7 | 38.8 |
| Private Mortgage Pool | 44.2 | 46.6 |
| Private Real Estate Pool | 40.4 | 43.1 |
| Standard & Poor's 500 Index Fund | 69.3 | 82.1 |
| Portable Alpha United States Equity Pool | 87.9 | – |
| **Externally Managed Investment Pools** | | |
| Absolute Return Strategy Pool | 88.5 | 88.5 |
| Canadian Large Cap Equity Pool | 8.0 | 21.9 |
| Canadian Small Cap Equity Pool | – | 8.2 |
| Canadian Equity Enhanced Index Pool | 60.2 | – |
| EAFE Core Equity Pool | 31.2 | 33.5 |
| EAFE Passive Equity Pool | 79.9 | 78.4 |
| EAFE Plus Equity Pool | 32.1 | 33.4 |
| Emerging Markets Equity Pool | 33.6 | – |
| US Large Cap Equity Pool | – | 35.2 |
| US Small/Mid Cap Equity Pool | 25.5 | 35.5 |

(a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining appropriate security and liquidity of depositors' capital. The portfolio is comprised of high-quality short-term and mid-term fixed-income securities with a maximum term-to-maturity of three years. As at March 31, 2005, securities held by the Fund have an average effective market yield of 2.79% per annum (2004: 2.11% per annum).

(b) The Canadian Dollar Public Bond Pool is managed with the objective of providing above average returns compared to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The excess return is achieved through management of portfolio duration and sector rotation. The portfolio is comprised of high quality Canadian fixed-income instruments and debt related derivatives. As at March 31, 2005, securities held by the Pool have an average effective market yield of 4.48% per annum (2004: 4.20% per annum) and the following term structure based on principal amount: under 1 year: 3% (2004: 2%); 1 to 5 years: 38% (2004: 40%); 5 to 10 years: 31% (2004: 30%); 10 to 20 years: 12% (2004: 10%); and over 20 years: 16% (2004: 18%).

(c) As at March 31, 2005, fixed-income securities held directly by the Fund have an average effective market yield of 3.18% per annum (2004: 2.69% per annum). As at March 31, 2005, fixed-income securities have the following term structure based on principal amount: under two years: 100% (2004: 100%).

(d) The Private Mortgage Pool is managed with the objective of providing investment returns higher than attainable from the Scotia Capital Universe Bond Index over a four-year period or longer. The portfolio is comprised primarily of high quality commercial mortgage loans (94.6%) and provincial bond residuals (5.4%). To limit investment risk, mortgage loans are restricted to first mortgage loans, diversified by property usage and geographic location, and include a small portion of NHA insured loans. As at March 31, 2005, securities held by the Pool have an average effective market yield of 5.29% per annum (2004: 5.50% per annum) and the following term structure based on principal amount: under 1 year: 2% (2004: 7%);

## FINANCIAL STATEMENTS

**Note 3 (continued)**

1 to 5 years: 22% (2004: 23%); 5 to 10 years: 43% (2004: 26%); 10 to 20 years: 12% (2004: 20%); and over 20 years: 21% (2004: 24%).

(e) As at March 31, 2005, Provincial corporation debentures have an average effective market yield of 7.51% per annum (2004: 7.10% per annum) and the following term structure based on principal amounts: 5 to 10 years: 100% (2004: 100%).

(f) Investments in loans are recorded at cost. The fair value of loans is estimated by management based on the present value of discounted cash flows. As at March 31, 2005, investment in loans, at cost, include the Ridley Grain loan amounting to $91,245 (2004: $91,245) and the Vencap loan amounting to $2,053 (2004: $1,899). The increase in the carrying value of the Vencap loan resulted from amortization of the loan on a constant yield basis.

- Under the terms of the loan to Ridley Grain, 11% Participating First Mortgage Bonds due July 31, 2015, interest is compounded semi-annually and payable annually to the extent of available cash flow and any shortfall is to be deferred and capitalized. The principal of $91,245 and deferred interest is repayable on or before July 31, 2015. Deferred interest at March 31, 2005 amounted to $92,517 (2004: $88,415). Grain throughput volumes are the main determinant of profitability of the grain terminal and the value of the loan to the Fund. Due to the uncertainty of forecasting the grain throughput volumes, income from the participating bonds is recognized when it is measurable and collectable.
- The principal amount of the Vencap loan, amounting to $52,588, is due July 2046 and bears no interest.

(g) The Overlay Pool provides participants with a quick, effective and efficient means to achieve tactical asset allocation opportunities without incurring undue transaction costs in the underlying investments. Long or short exposures to respective asset classes are obtained through synthetic instruments on a largely unfunded basis using equity index futures contracts. Approximately 5% to 10% of the Pool's notional exposure in Canadian and US futures contracts is supported by cash and short-term securities. The Overlay Pool is comprised of the "long" position through US futures contracts, the "short" position through Canadian futures contracts, and the "cash securities" position through money market securities. Taken together these three positions reduce exposure to Canadian equities and increase exposure to U.S. equities.

(h) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the Toronto Stock Exchange S&P/TSX Composite Index. The portfolio is comprised of publicly traded Canadian equities and structured investments replicating the S&P/TSX 60 Index. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool. FRNP is managed with the objective of generating floating rate income needed for the swap obligations in respect of structured investments in foreign equities, domestic equities and domestic bonds. Through the use of interest rate swaps, FRNP provides investment opportunities in high quality floating-rate instruments with remaining term-to-maturity of five years or less.

## FINANCIAL STATEMENTS

Note 3 (continued)

(i) The Canadian Pooled Equity Fund is managed with the objective of providing competitive returns comparable to the total return of the S&P/TSX Composite Index while maintaining maximum preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations. Risk is reduced by prudent security selection, while remaining sector neutral.

(j) The externally managed Canadian Equity Enhanced Index Pool allows participants the opportunity to gain investment exposure to the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year moving average period. The portfolio is comprised of publicly traded equities in Canadian corporations. The enhanced index generates a consistent level of return above the Index with relatively low risk.

(k) The Canadian Large Cap Equity Pool consists of multiple portfolios of publicly traded Canadian equities. The portfolios are actively managed by external managers with expertise in the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year period. Return volatility is reduced through multiple manager investment style and market capitalization focus.

(l) The Growing Equity Income Pool is managed with the objective of providing a steady and growing stream of dividend income by investing in mature Canadian and US companies with strong financial characteristics and growing distributions. Risk is reduced by holding established, well-capitalized companies. The performance of the pool is measured against the total return of a custom S&P/TSX Composite Index for dividend paying stocks.

(m) The Canadian Multi-Cap Pool allows participants to gain investment exposure to the Canadian equity market through internally managed structured investments replicating the S&P/TSX 60 Index and external actively managed Canadian small and mid cap investments. The performance of the pool is measured against the total return of the S&P/TSX Composite Index over a four-year moving average period.

(n) Publicly traded US equities held in the S&P 500 Index Fund replicate the Standard & Poor's (S&P) 500 Index. The performance objective is to provide returns comparable to the total return of the S&P 500 Index over a four-year period. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool (see Note 3(h)).

(o) The US Small/Mid Cap Equity Pool consists of one portfolio of publicly traded United States equities. The portfolio is actively managed by an external manager with expertise in the small cap and mid cap US equity market. The performance objective is to provide returns higher than the total return of the Russell 2500 Index over a four-year period.

(p) The Portable Alpha United States Equity Pool consists of futures and swap contracts which provide exposure to the U.S. equity market by replicating the S&P 500 Index and investments in value added absolute return strategies. The performance objective is to provide returns higher than the total return of the S&P 500 Index over a four-year period.

## FINANCIAL STATEMENTS

**Note 3 (continued)**

(q) The Europe, Australasia and Far East (EAFE) Core and Plus Equity Pools consist of multiple portfolios of publicly traded non-North American equities. EAFE Core portfolios are actively managed by external managers with European and Pacific Basin mandates. EAFE core managers have constraints on foreign currency management and deviations from the MSCI EAFE Index asset mix by country. The EAFE Plus portfolios are actively managed by external managers with less constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital International (MSCI) EAFE Index over a four-year period.

(r) The externally managed EAFE Passive Equity Pool consists of one portfolio of non-North American publicly traded equities that replicates the MSCI EAFE Index. The performance objective is to provide returns comparable to the total return of the MSCI EAFE Index over a four-year period.

(s) The External Managers Emerging Markets Equity Pool consists of publicly traded equities in emerging markets around the world. The portfolio is actively managed by external managers with expertise in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital Index Emerging Markets Free (MSCI EMF) Index over a four-year period.

(t) The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index plus 5%. Real estate is held through intermediary companies, which have issued to the Pool, common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. As real estate returns are positively correlated to inflation and negatively correlated to returns from fixed income securities and equities, the Pool provides diversification from the securities market with opportunities for high return.

(u) The Foreign Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index plus 5%. The Pool provides diverse exposure to non-domestic real estate by investing in foreign real estate backed securities and assets.

(v) The Absolute Return Strategy Pool is managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 6%. The Pool uses external managers who employ various investment strategies. These strategies are expected to produce absolute positive investment returns with lower volatility.

(w) Private Equity Pools are managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 8.0%. The Private Equity Portfolio consists of the Private Equity Pool, PEP98, PEP02, PEP04 and the Foreign Private Equity Pool 2002. Private equity investments are held in institutionally sponsored private equity pools. Risk is reduced by avoiding direct investments in private companies and by limiting holdings in any single pool. The Private Income Pool invests in infrastructure related projects that are structured to yield high current income with the objective of providing investment returns higher than the CPI plus 6.0%.

Note 3 (continued)

(x) Where there has been a loss in value of an investment that is other than a temporary decline, the cost of the investment is written down to recognize the loss (see Note 2 (a)). Where the fair value remains less than cost, after recording a writedown, it is management's best judgement that the decline in value is caused by short-term market trends and is temporary in nature.

## NOTE 4 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Fund uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to interest rate risk and foreign currency risk and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

(i) A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. A credit default swap allows counter-parties to buy and sell protection on credit risk inherent in a bond. A premium is paid, based on a notional amount, from one counter party to a second counter party in exchange for a contingent payment should a defined credit event occur with respect to the underlying security. There are underlying securities supporting all swaps. Leveraging is not allowed.

(ii) Forward foreign exchange contracts are contractual agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

(iii) An equity index futures contract is an agreement to receive or pay cash based on changes in the level of the specified stock index.

## FINANCIAL STATEMENTS

Note 4 (continued)

The following is a summary of the Fund's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at March 31, 2005.

| | Maturity | | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|---|
| | Under 1 Year | 1 to 3 Years | Over 3 Years | Notional Amount (a) | Fair Value (b) | Notional Amount (a) | Fair Value (b) |
| | | | | *(thousands)* | | | |
| Equity index swap contracts | 66% | 34% | – | $ 1,534,324 | $ 7,673 | $ 1,117,982 | $ (8,244) |
| Interest rate swap contracts | 39% | 49% | 12% | 491,031 | (12,449) | 684,837 | (30,484) |
| Forward foreign exchange contracts | 100% | – | – | 935,430 | 13,334 | 590,114 | 4,825 |
| Cross-currency interest rate swaps | 8% | 31% | 61% | 580,540 | 2,228 | 398,256 | (45,969) |
| Credit default swap contracts | 32% | 11% | 57% | 128,430 | 1,384 | 49,141 | (384) |
| Bond index swap contracts | 100% | – | – | 61,311 | 428 | 45,613 | 1,114 |
| Equity index futures contracts | 100% | – | – | 302,125 | 5,957 | 8,919 | 965 |
| | | | | $4,033,191 | $ 18,555 | $ 2,894,862 | $ (78,177) |

(a) The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Fund attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

(b) The method of determining the fair value of derivative contracts is described in note 2 (e).

### NOTE 5 INVESTMENT RISK MANAGEMENT

Income and financial returns of the Fund are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

The Standing Committee on the Alberta Heritage Savings Trust Fund reviews and approves the business plan of the Fund. In order to earn an optimal financial return at an acceptable level of risk, the 2004-2007 Business Plan proposed the following asset mix policy for the Fund.

| | 2004-05 | 2005-06 | 2006-07 |
|---|---|---|---|
| Public equities | 46.0% | 45.0% | 45.0% |
| Fixed income securities | 35.0% | 35.0% | 32.5% |
| Real estate | 10.0% | 10.0% | 10.0% |
| Absolute Return Strategies | 5.0% | 5.0% | 7.5% |
| Private equities | 4.0% | 5.0% | 5.0% |

Risk is reduced through asset class diversification, diversification within each asset class, quality and duration constraints on fixed-income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 4). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in foreign currency (see Note 4).

### NOTE 6 FUND EQUITY

Section 8 (2) of the *Alberta Heritage Savings Trust Fund Act* (the *Act*) states that the net income of the Heritage Fund less any amount retained in the Fund to maintain its value shall be transferred to the General Revenue Fund annually in a manner determined by the Minister of Finance.

Section 11(4) of the Act states that for fiscal years subsequent to 1999 and until the accumulated debt is eliminated in accordance with the *Fiscal Responsibility Act*, the Minister of Finance is not required to retain any income in the Heritage Fund to maintain its value, but may retain such amounts as the Minister of Finance considers advisable.

# FINANCIAL STATEMENTS

## NOTE 7 NET INCOME (LOSS)

| | 2005 | 2004 |
|---|---|---|
| | *(thousands)* | |
| Deposit and fixed-income securities | $ 264,136 | $ 304,331 |
| Canadian equities | 450,950 | 509,551 |
| United States equities | 9,086 | 46,191 |
| Non-North American equities | 258,049 | 175,183 |
| Private equities and income | 11,109 | 7,934 |
| Real estate | 68,678 | 54,392 |
| Absolute return strategies | 32,098 | 38,069 |
| **Investment income** | 1,094,106 | 1,135,651 |
| Direct administrative expenses (Note 8) | (2,203) | (2,166) |
| **Net income** | $ 1,091,903 | $ 1,133,485 |

Investment income is comprised of interest, dividends, amortization of discount and premiums, swap income, security lending income and realized gains and losses, net of write-downs, on investments. The Fund's share of income earned from externally and internally managed investment pools is net of administrative expenses incurred by the pools (see Note 8).

The investment income for the year ended March 31, 2005 includes writedowns totalling $34,425 (2004: $2,630).

## NOTE 8 ADMINISTRATIVE EXPENSES

Administrative expense includes investment management, cash management, safekeeping costs and other expenses charged on a cost-recovery basis directly from Alberta Finance. The Fund's total administrative expense for the period, including amounts deducted directly from investment income of pooled funds, is as follows:

| | 2005 | 2004 |
|---|---|---|
| | *(thousands)* | |
| Direct fund expenses (Note 7) | $ 2,203 | $ 2,166 |
| Externally managed investment pools | 14,792 | 12,338 |
| Internally managed investment pools | 3,713 | 3,425 |
| Total | $ 20,708 | $ 17,929 |
| Percent of net assets at fair value | 0.169% | 0.145% |

## NOTE 9 INVESTMENT PERFORMANCE (SCHEDULE F)

The following is a summary of the overall investment performance results attained by the Fund determined on a fair value basis:

| | One Year Return | Five Year Compound Annualized Return |
|---|---|---|
| **Time-weighted rates of return** | | |
| Overall actual return | 7.7% | 4.1% |
| Benchmark return* | 6.4% | 6.9% |

*The benchmark return for the year ended March 31, 2005 is a product of the weighted average policy sector weights and the sector benchmark returns. The Fund is expected to generate a real rate of return of 4.5% over a moving five-year period based on the Fund's business plan. Over a five-year period, the annualized inflation rate was 2.4%. Therefore, the fund is expected to generate a nominal annualized rate of return of 6.9%.

## NOTE 10 APPROVAL OF FINANCIAL STATEMENTS

These financial statements were approved by the Deputy Minister of Finance.

FINANCIAL STATEMENTS

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES

**Schedule A**

**March 31, 2005 (thousands)**

| | Fund's share | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 103,527 | $ 103,527 | $ 118,768 | $ 118,768 |
| **Fixed income securities (a)** | | | | |
| Corporate, public and private | 1,890,339 | 1,905,009 | 2,130,560 | 2,165,983 |
| Government of Canada, direct and guaranteed | 960,687 | 968,395 | 783,122 | 793,410 |
| Provincial, direct and guaranteed: | | | | |
| Alberta | 1,781 | 1,931 | 2,159 | 2,377 |
| Other provinces | 712,581 | 761,815 | 745,529 | 801,819 |
| Municipal | 37,860 | 39,985 | 41,586 | 43,785 |
| Provincial corporation debentures | 88,340 | 132,261 | 94,656 | 150,125 |
| Loans | 93,298 | 93,298 | 93,144 | 93,144 |
| | 3,784,886 | 3,902,694 | 3,890,756 | 4,050,643 |
| Receivable from sale of investments and accrued investment income | 43,651 | 43,651 | 40,472 | 40,472 |
| Accounts payable and accrued liabilities | (18,279) | (18,279) | (45,660) | (45,660) |
| | 25,372 | 25,372 | (5,188) | (5,188) |
| | **$ 3,913,785** | **$ 4,031,593** | **$ 4,004,336** | **$ 4,164,223** |

(a) Fixed income securities held as at March 31, 2005 have an average effective market yield of 4.84% per annum (2004: 4.53% per annum) and the following term structure based on principal amount:

| | 2005 | 2004 |
|---|---|---|
| | % | % |
| under 1 year | 3 | 3 |
| 1 to 5 years | 33 | 35 |
| 5 to 10 years | 36 | 32 |
| 10 to 20 years | 11 | 11 |
| over 20 years | 17 | 19 |
| | 100 | 100 |

FINANCIAL STATEMENTS

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES

**Schedule B**

**March 31, 2005 (thousands)**

| | Fund's share | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 17,140 | $ 17,140 | $ 19,490 | $ 19,490 |
| **Public equities (a) (b)** | | | | |
| Consumer discretionary | 136,794 | 143,247 | 185,183 | 196,016 |
| Consumer staples | 81,341 | 98,161 | 90,335 | 110,909 |
| Energy | 357,358 | 459,663 | 317,651 | 404,651 |
| Financials | 637,357 | 725,438 | 769,038 | 901,733 |
| Health care | 30,952 | 30,464 | 51,479 | 56,827 |
| Industrials | 99,590 | 121,832 | 184,151 | 209,612 |
| Information technology | 118,285 | 121,644 | 161,932 | 204,279 |
| Materials | 276,563 | 322,935 | 381,880 | 451,810 |
| Telecommunication services | 123,781 | 138,568 | 133,260 | 131,202 |
| Utilities | 24,398 | 31,333 | 90,691 | 100,631 |
| | 1,886,419 | 2,193,285 | 2,365,600 | 2,767,670 |
| Small Cap Pooled Fund | 41,766 | 42,271 | 628 | 593 |
| Receivable from sale of investments and accrued investment income | 37,239 | 37,239 | 10,835 | 10,835 |
| Accounts payable and accrued liabilities | (24,862) | (24,862) | (30,445) | (30,445) |
| | 12,377 | 12,377 | (19,610) | (19,610) |
| | **$ 1,957,702** | **$ 2,265,073** | **$ 2,366,108** | **$ 2,768,143** |

(a) The Fund's effective net investment in Canadian public equities includes the notional amount of Canadian equity index swap contracts and equity index futures contracts totalling $907,201 (2004: $809,440).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

FINANCIAL STATEMENTS

## SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES

**Schedule C**

**March 31, 2005 (thousands)**

| | Fund's share | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 29,803 | $ 29,803 | $ 29,995 | $ 29,995 |
| **Public equities (a) (b)** | | | | |
| Consumer discretionary | 218,328 | 233,740 | 292,063 | 311,021 |
| Consumer staples | 177,873 | 184,501 | 175,500 | 183,849 |
| Energy | 151,561 | 171,637 | 107,832 | 112,968 |
| Financials | 387,321 | 398,319 | 357,904 | 400,188 |
| Health care | 249,009 | 255,525 | 240,502 | 238,498 |
| Industrials | 233,052 | 248,242 | 204,356 | 220,671 |
| Information Technology | 287,905 | 298,195 | 282,604 | 313,416 |
| Materials | 72,307 | 77,985 | 59,136 | 70,825 |
| Telecommunication services | 52,937 | 54,077 | 55,511 | 55,753 |
| Utilities | 65,324 | 70,617 | 43,449 | 46,933 |
| | 1,895,617 | 1,992,838 | 1,818,857 | 1,954,122 |
| Receivable from sale of investments and accrued investment income | 16,281 | 16,281 | 7,408 | 7,408 |
| Accounts payable and accrued liabilities | (47,363) | (47,363) | (29,693) | (29,693) |
| | (31,082) | (31,082) | (22,285) | (22,285) |
| | $ 1,894,338 | $ 1,991,559 | $ 1,826,567 | $ 1,961,832 |

(a) The Fund's effective net investment in US public equities includes the notional amount of US equity index swap contracts and equity index futures contracts totalling $929,248 (2004: $317,461).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard & Poor's (S&P) 500 Index.

FINANCIAL STATEMENTS

## SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES — Schedule D

**March 31, 2005 (thousands)**

| | Fund's share | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 37,408 | $ 37,408 | $ 40,551 | $ 40,551 |
| **Public equities (a)** | | | | |
| Consumer discretionary | 237,437 | 253,047 | 266,480 | 314,210 |
| Consumer staples | 101,731 | 109,365 | 135,141 | 150,389 |
| Energy | 143,749 | 165,802 | 140,245 | 154,046 |
| Financials | 439,381 | 500,068 | 405,030 | 484,429 |
| Health care | 111,514 | 113,706 | 150,885 | 156,468 |
| Industrials | 200,853 | 226,907 | 197,744 | 232,027 |
| Information technology | 91,900 | 94,916 | 97,954 | 125,276 |
| Materials | 145,507 | 166,576 | 130,807 | 155,861 |
| Telecommunication services | 155,675 | 161,388 | 142,311 | 158,735 |
| Utilities | 74,749 | 82,541 | 67,353 | 78,851 |
| | 1,702,496 | 1,874,316 | 1,733,950 | 2,010,292 |
| Emerging market pooled funds | 55,559 | 58,803 | – | – |
| Receivable from sale of investments and accrued investment income | 23,849 | 23,849 | 21,318 | 21,318 |
| Accounts payable and accrued liabilities | (20,405) | (20,405) | (19,319) | (19,319) |
| | 3,444 | 3,444 | 1,999 | 1,999 |
| | $ 1,798,907 | $ 1,973,971 | $ 1,776,500 | $ 2,052,842 |

(a) The sector classification conforms to the Global Industry Classification Standard followed by Standard & Poor's. Public equities by geographic location are as follows:

**Public equities by country**

| | Fund's share | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| | Cost | Fair Value | Cost | Fair Value |
| United Kingdom | $ 380,864 | $ 405,968 | $ 421,563 | $ 462,861 |
| Japan | 312,925 | 320,278 | 318,432 | 385,621 |
| France | 162,309 | 183,838 | 163,625 | 188,025 |
| Germany | 119,400 | 131,916 | 119,043 | 136,328 |
| Switzerland | 106,425 | 117,242 | 142,150 | 157,843 |
| Netherlands | 91,777 | 100,489 | 98,481 | 109,348 |
| Australia | 67,350 | 83,907 | 73,965 | 98,036 |
| Italy | 59,403 | 71,454 | 77,319 | 88,605 |
| Spain | 46,605 | 54,061 | 44,093 | 53,543 |
| Sweden | 44,048 | 49,991 | 30,189 | 37,619 |
| Other | 311,390 | 355,172 | 245,090 | 292,463 |
| | $ 1,702,496 | $ 1,874,316 | $ 1,733,950 | $ 2,010,292 |

# FINANCIAL STATEMENTS

## SCHEDULE OF INVESTMENTS IN REAL ESTATE

**Schedule E**

**March 31, 2005 (thousands)**

| | Fund's share | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 469 | $ 469 | $ 1,162 | $ 1,162 |
| **Real estate (a)** | | | | |
| Office | 453,555 | 522,348 | 369,962 | 422,531 |
| Retail | 360,867 | 465,131 | 378,702 | 402,264 |
| Industrial | 79,273 | 90,736 | 57,490 | 63,298 |
| Residential | 53,785 | 51,850 | 53,909 | 49,782 |
| | 947,480 | 1,130,065 | 860,063 | 937,875 |
| Foreign Private Real Estate Pool | 43,161 | 40,948 | – | – |
| Participation units | 16,571 | 16,571 | 8,355 | 8,355 |
| **Accrued income and accounts receivable** | 1,521 | 1,521 | 2,379 | 2,379 |
| | **$ 1,009,202** | **$ 1,189,574** | **$ 871,959** | **$ 949,771** |

(a) The following is a summary of real estate investments by geographic location:

| | Fund's share | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| | Cost | Fair Value | Cost | Fair Value |
| Ontario | $ 606,473 | $ 752,027 | $ 635,609 | $ 693,793 |
| Alberta | 192,339 | 234,630 | 206,072 | 224,660 |
| Quebec | 126,049 | 118,870 | – | – |
| British Columbia | 22,619 | 24,538 | 18,382 | 19,422 |
| | $ 947,480 | $ 1,130,065 | $ 860,063 | $ 937,875 |

## SCHEDULE OF INVESTMENT RETURNS

**Schedule F**

**Year Ended March 31, 2005**

The Fund uses a time-weighted rate of return based on market values to measure performance. The measure involves the calculation of the return realized by the Fund over a specified period and is a measure of the total return received from an investment dollar initially invested. Total return includes cash distributions (interest and dividend payments) and capital gains or losses (realized and unrealized).

The time-weighted rate of return measures the compounded rate of growth of the initial investment over the specified period. It is designed to eliminate the effect that the size and timing of cash flows have on the internal rate of return. The investment industry uses time-weighted rates of return calculated using market values when comparing the returns of funds with other funds or indices.

Investment returns for the Fund are as follows:

| | One Year Return | | | | | 5 Year Compound Annualized |
|---|---|---|---|---|---|---|
| Time-weighted Rates of Return | 2005 | 2004 | 2003 | 2002 | 2001 | Return |
| **Short-term fixed income** | **2.3** | **2.9** | **3.0** | **3.8** | **5.7** | **3.5** |
| *Scotia Capital 91-day T-Bill Index* | *2.2* | *3.0* | *2.7* | *3.7* | *5.7* | *3.5* |
| **Long-term fixed income** | **5.5** | **11.6** | **9.5** | **5.9** | **9.5** | **8.4** |
| *Scotia Capital Universe Bond Index* | *5.0* | *10.8* | *9.2* | *5.1* | *8.7* | *7.7* |
| **Canadian equities** | **15.4** | **36.6** | **(16.6)** | **4.2** | **(16.0)** | **2.9** |
| *S&P/TSX Composite Index* | *13.9* | *37.7* | *(17.6)* | *4.9* | *(18.6)* | *2.0* |
| **United States equities** | **(1.6)** | **22.1** | **(30.6)** | **1.4** | **(14.4)** | **(6.3)** |
| *S&P 1500 Index* | *(1.0)* | *20.5* | *(30.7)* | *1.6* | *(15.1)* | *(6.5)* |
| **Non-North American equities** | **7.6** | **40.9** | **(29.1)** | **(5.8)** | **(22.6)** | **(4.8)** |
| *MSCI EAFE Index* | *6.2* | *40.5* | *(29.3)* | *(7.3)* | *(19.6)* | *(4.7)* |
| **Real estate** | **17.0** | **7.5** | **9.8** | **7.3** | **9.7** | **10.2** |
| *Consumer Price Index plus 5%* | *7.1* | *5.7* | *9.6* | *9.9* | *11.9* | *8.8* |
| **Absolute return strategies** | **5.5** | **10.7** | **1.6** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index plus 6%* | *8.1* | *6.7* | *4.7* | *n/a* | *n/a* | *n/a* |
| **Private equities** | **5.2** | **4.6** | **(3.3)** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index plus 8%* | *10.1* | *8.7* | *5.7* | *n/a* | *n/a* | *n/a* |
| **Private income** | **5.3** | **0.0** | **0.0** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index plus 6%* | *8.1* | *0.0* | *0.0* | *n/a* | *n/a* | *n/a* |
| **Total Endowment portfolio** | **7.7** | **22.5** | **(11.3)** | **3.3** | **(6.1)** | **2.6** |
| *Policy Benchmark* | *6.4* | *21.7* | *(11.7)* | *3.4* | *(6.2)* | *2.1* |
| **Transition portfolio** | **n/a** | **n/a** | **0.5** | **5.3** | **8.2** | **n/a** |
| **Overall Return** | **7.7** | **22.5** | **(11.0)** | **4.2** | **(0.1)** | **4.1** |

# List of Investments (unaudited)

The following unaudited schedules (1 to 14) present the Heritage Fund's proportionate share of the ten largest public securities held in pooled funds administered by Alberta Finance. For a detailed listing of all investments, please call (780) 427-5364.

## CANADIAN DOLLAR PUBLIC BOND POOL

SCHEDULE 1

**Schedule of Ten Largest Issues (based on fair value)**

**as at March 31, 2005 (thousands)**

| Security Name | Coupon % Maturity Date | Heritage Fund Share Par Value | Cost | Fair Value |
|---|---|---|---|---|
| Government of Canada | 5.750 JUN 01 29 | $ 43,556 | $ 51,725 | $ 51,670 |
| Province of Quebec | 6.000 OCT 01 29 | 36,051 | 37,755 | 41,095 |
| MBS-Toronto Dominion | 5.600 JUN 01 24 | 32,616 | 32,984 | 35,527 |
| 55 School Board Trust | 5.900 JUN 02 33 | 26,720 | 27,646 | 29,990 |
| Province of Quebec | 7.500 JUL 15 23 US | 17,457 | 23,668 | 27,462 |
| MBS-Bank of Nova Scotia | 4.900 DEC 01 12 | 25,785 | 25,916 | 27,298 |
| Province of Quebec | 7.125 FEB 09 24 US | 17,901 | 24,651 | 27,106 |
| Score Trust | 4.949 FEB 20 14 | 25,651 | 26,558 | 27,079 |
| Province of Nova Scotia | 11.750 APR 18 19 GB | 6,266 | 15,492 | 24,248 |
| Windsor Trust | 4.094 JUN 15 08 | 23,157 | 23,976 | 24,191 |
| **Total Other Issues** | | | 2,803,897 | 2,838,355 |
| **Heritage Fund's Investment in the Canadian Dollar Public Bond Pool** | | | $ 3,094,268 | $ 3,154,021 |

# DOMESTIC PASSIVE EQUITY POOLED FUND

SCHEDULE 2

## Schedule of Ten Largest Issues (based on fair value)

as at March 31, 2005 (thousands)

ACTUAL INVESTMENT

| Security Name | Major Industry Name | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| Floating Rate Note Pool (1) | Floating Rate Notes | 399,147 | $ 459,615 | $ 458,217 |
| Deposits and short term securities (1) | Cash and cash equivalents | - | 74,260 | 76,107 |
| Power Corporation of Canada | Financials | 3,176 | 3,816 | 7,386 |
| Power Financial Corp | Financials | 2,389 | 2,909 | 5,943 |
| Great West Life | Financials | 2,289 | 2,426 | 4,725 |
| Goldcorp Inc | Materials | 3,415 | 2,169 | 4,569 |
| Shell Canada | Energy | 623 | 1,637 | 4,209 |
| Penn West Petroleum Ltd | Energy | 554 | 1,410 | 3,442 |
| IGM Financial | Financials | 1,104 | 2,029 | 3,225 |
| Telesystem International | Telecommunications | 2,211 | 2,037 | 3,170 |
| **Total Other Issues** | | | 315,933 | 418,247 |
| **Heritage Fund's Investment in the Domestic Passive Equity Pooled Fund** | | | $ 868,241 | $ 989,240 |

EFFECTIVE INVESTMENT (1)

| Security Name | Major Industry Name | Heritage Fund Share |
|---|---|---|
| | | Fair Value |
| Royal Bank of Canada | Financials | $ 48,681 |
| Manulife Financial Corp | Financials | 47,810 |
| Bank of Nova Scotia | Financials | 40,509 |
| Encana Corp | Energy | 39,144 |
| Toronto Dominion Bank | Financials | 36,216 |
| Bank of Montreal | Financials | 28,915 |
| BCE Inc | Telecommunications | 28,747 |
| Canadian Imperial Bank of Commerce | Financials | 29,282 |
| Sun Life Financial Inc | Financials | 23,979 |
| Suncor Energy Inc | Energy | 22,723 |
| **Total Other Issues** | | 643,234 |
| **Heritage Fund's Investment in the Domestic Passive Equity Pooled Fund** | | $ 989,240 |

(1) Floating rate notes, deposits and short term securites are underlying securities for S&P/TSX equity index swaps

## CANADIAN POOLED EQUITY FUND

SCHEDULE 3

**Schedule of Ten Largest Issues (based on fair value)**

as at March 31, 2005 (thousands)

| Security Name | Major Industry Name | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| Manulife Financial Corp | Financials | 6,075 | $ 29,253 | $ 36,441 |
| Toronto Dominion Bank | Financials | 6,594 | 27,888 | 34,316 |
| Encana Corporation | Energy | 3,485 | 15,953 | 30,926 |
| Canadian Imperial Bank of Commerce | Financials | 3,533 | 20,713 | 26,921 |
| Canadian National Railway | Industrials | 2,648 | 14,885 | 21,001 |
| Royal Bank of Canada | Financials | 2,623 | 12,406 | 20,043 |
| Petro Canada | Energy | 2,684 | 12,313 | 19,584 |
| Bank of Nova Scotia | Financials | 4,766 | 14,122 | 19,580 |
| Teck Cominco | Materials | 3,652 | 6,530 | 17,012 |
| Talisman Energy Inc | Energy | 3,611 | 6,892 | 15,525 |
| **Total Other Issues** | | | 330,500 | 364,076 |
| **Heritage Fund's Investment in the Canadian Pooled Equity Fund** | | | **$ 491,455** | **$ 605,425** |

## EXTERNAL MANAGERS CANADIAN LARGE CAP EQUITY POOL

SCHEDULE 4

**Schedule of Ten Largest Issues (based on fair value)**

as at March 31, 2005 (thousands)

| Security Name | Major Industry Name | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| Bank of Nova Scotia | Financials | 2,656 | $ 7,719 | $ 12,695 |
| Encana Corp | Energy | 1,211 | 6,937 | 12,500 |
| Manulife Financial Corp | Financials | 1,601 | 8,384 | 11,175 |
| Royal Bank of Canada | Financials | 1,007 | 6,317 | 8,949 |
| Toronto Dominion Bank | Financials | 1,437 | 6,275 | 8,702 |
| Petro Canada | Energy | 939 | 5,037 | 7,976 |
| Sun Life Financial | Financials | 1,578 | 6,361 | 7,522 |
| Alcan Inc | Materials | 1,101 | 6,352 | 6,124 |
| Telus Corp | Telecommunciations | 1,341 | 3,360 | 6,122 |
| Bank of Montreal | Financials | 875 | 3,663 | 5,941 |
| **Total Other Issues** | | | 103,391 | 96,536 |
| **Heritage Fund's Investment in the External Managers Canadian Large Cap Equity Pool** | | | **$ 163,796** | **$ 184,242** |

## GROWING EQUITY INCOME POOL (CANADIAN AND US)

SCHEDULE 5

**Schedule of Ten Largest Issues (based on fair value)**

as at March 31, 2005 (thousands)

| Security Name | Major Industry Name | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| Toronto Dominion Bank | Financials | 3,139 | $ 14,553 | $ 15,554 |
| Manulife Financial Corp | Financials | 1,765 | 8,128 | 10,084 |
| Shell Canada | Energy | 1,013 | 6,213 | 8,715 |
| Encana Corporation | Energy | 1,029 | 5,685 | 8,692 |
| Canadian National Railway | Industrials | 1,116 | 6,143 | 8,427 |
| Canadian Imperial Bank of Commerce | Financials | 1,002 | 6,527 | 7,271 |
| Teck Cominco Ltd | Materials | 1,581 | 3,351 | 7,013 |
| Bank of America Corp | US Financials | 1,263 | 6,917 | 6,663 |
| Petro Canada | Energy | 877 | 5,235 | 6,096 |
| Royal Bank of Canada | Financials | 805 | 5,003 | 5,859 |
| **Total Other Issues** | | | 85,316 | 92,797 |
| **Heritage Fund's Investment in the Growing Equity Income Pool (Canadian and US)** | | | **$ 153,071** | **$ 177,171** |

## CANADIAN ENHANCED EQUITY INDEX POOL

SCHEDULE 6

### Schedule of Ten Largest Issues (based on fair value)

as at March 31, 2005 (thousands)

| Security Name | Major Industry Name | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| Royal Bank of Canada | Financials | 2,595 | $ 16,211 | $ 18,560 |
| Manulife Financial Corporaion | Financials | 3,002 | 16,376 | 16,855 |
| Encana Corporation | Energy | 1,734 | 11,457 | 14,402 |
| Canadian Imperial Bank of Commerce | Financials | 1,960 | 13,622 | 13,977 |
| National Bank of Canada | Financials | 2,117 | 9,914 | 10,778 |
| Canadian Natural Resources Limited | Energy | 1,618 | 8,654 | 10,752 |
| BCE Inc | Telecommunication services | 3,347 | 9,291 | 9,845 |
| Canadian National Railway Corp | Industrials | 1,180 | 7,645 | 8,760 |
| Brascan Corp | Financials | 1,807 | 7,607 | 8,031 |
| Telus Corp | Telecommunication services | 2,043 | 6,350 | 7,724 |
| **Total Other Issues** | | | 184,986 | 200,011 |
| **Heritage Fund's Investment in the Canadian Enhanced Equity Index Pool** | | | **$ 292,113** | **$ 319,695** |

## CANADIAN MULTI-CAP POOL

SCHEDULE 7

### Schedule of Ten Largest Issues (based on fair value)

as at March 31, 2005 (thousands)

**ACTUAL INVESTMENT**

| Security Name | Major Industry Name | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| Floating Rate Note Pool (1) | Floating Rate Notes | 57,395 | $ 85,297 | $ 84,980 |
| BGICL Small Cap Ace Fund | Small cap equities | 36,915 | 41,766 | 42,310 |
| Deposits (1) | Cash and cash equivalents | - | 10,570 | 10,570 |
| **Total Other Issues** | | | 1,214 | 1,098 |
| **Heritage Fund's Investment in the Canadian Multi-Cap Pool** | | | **$ 138,847** | **$ 138,958** |

**EFFECTIVE INVESTMENT (1)**

| Security Name | Major Industry Name | Heritage Fund Share |
|---|---|---|
| | | Fair Value |
| BGICL Small Cap Ace Fund | Small cap equities | $ 84,980 |
| Royal Bank of Canada | Financials | 6,221 |
| Manulife Financial Corp | Financials | 6,109 |
| Bank of Nova Scotia | Financials | 5,177 |
| Encana Corp | Energy | 5,002 |
| Toronto Dominion Bank | Financials | 4,628 |
| Bank of Montreal | Financials | 3,695 |
| BCE Inc. | Telecommunications | 3,673 |
| Canadian Imperial Bank of Commerce | Financials | 3,282 |
| Sun Life Financial Inc | Financials | 3,064 |
| **Total Other Issues** | | 13,127 |
| **Heritage Fund's Investment in the Canadian Multi-Cap Pool** | | **$ 138,958** |

(1) Floating rate notes, deposits and short term securites are underlying securities for S&P/TSX60 equity index swaps

# S&P 500 INDEX FUND

SCHEDULE 8

## Schedule of Ten Largest Issues (based on fair value)

as at March 31, 2005 (thousands)

### ACTUAL INVESTMENT

| Security Name | Major Industry Name | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| Floating Rate Note Pool (1) | Floating rate notes | 197,863 | $ 240,422 | $ 239,889 |
| Cash and short term securities (1) | Cash and cash equivalents | - | 162,297 | 164,684 |
| General Electric Company | Industrials | 6,507 | 27,007 | 23,262 |
| Exxon Mobil Corp | Energy | 3,931 | 22,339 | 23,229 |
| Microsoft Corp | Information technology | 6,212 | 18,929 | 14,885 |
| Citigroup Inc | Financials | 3,208 | 16,958 | 14,292 |
| Johnson & Johnson | Healthcare | 1,826 | 12,208 | 12,155 |
| Pfizer Inc | Healthcare | 4,574 | 19,647 | 11,912 |
| Bank of America Corp | Financials | 2,489 | 10,027 | 10,882 |
| Wal Mart Stores Inc | Consumer staples | 2,080 | 13,795 | 10,332 |
| **Total Other Issues** | | | 635,876 | 758,751 |
| **Heritage Fund's Investment in the S&P 500 Index Fund** | | | **$ 1,179,505** | **$ 1,284,273** |

### EFFECTIVE INVESTMENT (1)

| Security Name | Heritage Fund Share Fair Value |
|---|---|
| General Electric Company | $ 40,430 |
| Exxon Mobil Corp | 40,349 |
| Microsoft Corp | 25,877 |
| Citigroup Inc | 24,846 |
| Johnson & Johnson | 21,153 |
| Pfizer Inc | 20,715 |
| Bank of America Corp | 18,907 |
| Wal-Mart Stores | 17,968 |
| International Business Machines | 17,896 |
| Intel Corp | 17,317 |
| **Total Other Issues** | 1,038,815 |
| **Heritage Fund's Investment in the S&P 500 Index Fund** | **$ 1,284,273** |

(1) Floating rate notes, deposits and short term securites are underlying securities for S&P 500 equity index swaps

# PORTABLE ALPHA US EQUITY POOL

SCHEDULE 9

## Schedule of Ten Largest Issues (based on fair value)

as at March 31, 2005 (thousands)

### ACTUAL INVESTMENTS

| Security Name | Major Industry Name | Heritage Fund Share Cost | Heritage Fund Share Fair Value |
|---|---|---|---|
| Pooled Funds (1) | Absolute return strategies | $ 268,866 | $ 259,696 |
| Cash and short term securities (1) | Cash and cash equivalents | 78,121 | 77,039 |
| **Total Other Issues** | | (20,287) | (20,395) |
| **Heritage Fund's Investment in the Portable Alpha US Equity Pool** | | **$ 326,700** | **$ 316,340** |

### EFFECTIVE INVESTMENT (1)

| Security Name | Heritage Fund Share Fair Value |
|---|---|
| General Electric Company | $ 11,887 |
| Exxon Mobil Corp | 11,853 |
| Microsoft Corp | 7,610 |
| Citigroup Inc | 7,307 |
| Johnson & Johnson | 6,230 |
| Pfizer Inc | 6,095 |
| Bank of America Corp | 5,556 |
| Wal-Mart Stores | 5,287 |
| International Business Machines | 4,647 |
| Intel Corp | 4,512 |
| **Total Other Issues** | 245,356 |
| **Heritage Fund's Investment in the Portable Alpha US Equity Pool** | **$ 316,340** |

(1) Floating rate notes, deposits and short term securites are underlying securities for S&P 500 equity index swaps

# EXTERNAL MANAGERS EAFE CORE EQUITY POOL

SCHEDULE 10

## Schedule of Ten Largest Issues (based on fair value)

as at March 31, 2005 (thousands)

| Security Name | Major Industry Name | Country | Heritage Fund Share Shares | Heritage Fund Share Cost | Heritage Fund Share Fair Value |
|---|---|---|---|---|---|
| Sanofi Aventis | Health Care | France | 244 | $ 24,353 | $ 24,887 |
| Total SA | Energy | France | 79 | 18,932 | 22,431 |
| Credit Suisse Group | Financials | Switzerland | 318 | 13,838 | 16,530 |
| Vodafone Group | Telecommunicaitons services | United Kindgom | 5,132 | 16,314 | 16,473 |
| Prudential PLC | Financials | United Kingdom | 1,247 | 14,407 | 14,416 |
| BP PLC | Energy | United Kingdom | 995 | 12,914 | 12,474 |
| Repsol YPF SA | Energy | Spain | 381 | 11,133 | 12,199 |
| ENI | Energy | Italy | 375 | 8,890 | 11,774 |
| ABN AMRO Holdings NV | Financials | Netherlands | 391 | 11,761 | 11,752 |
| Toyoto Motor Corp | Consumer Discretionary | Japan | 232 | 10,449 | 10,457 |
| **Total Other Issues** | | | | 783,663 | 823,703 |
| **Heritage Fund's Investment in the External Managers EAFE Core Equity Pool** | | | | **$ 926,654** | **$ 977,096** |

## EXTERNAL MANAGERS US SMALL-MID CAP EQUITY POOL

**SCHEDULE 11**

### Schedule of Ten Largest Issues (based on fair value)

as at March 31, 2005 (thousands)

| | | Heritage Fund Share | | |
|---|---|---|---|---|
| Security Name | Major Industry Name | Shares | Cost | Fair Value |
| Chesapeake Energy Corp | Energy | 1,571 | $ 3,083 | $ 4,301 |
| Celgene Corp | Health Care | 785 | 2,839 | 3,334 |
| Pacificare Health Systems | Health Care | 445 | 2,294 | 3,164 |
| Autoliv | Consumer Discretionary | 497 | 2,764 | 2,957 |
| SSGA Funds | Cash and short term securities | 22,768 | 2,847 | 2,841 |
| Darden Restaurants Inc | Consumer Discretionary | 664 | 2,266 | 2,541 |
| Humana Inc | Health Care | 622 | 1,691 | 2,479 |
| United Sts Stl Corp New | Materials | 386 | 2,192 | 2,450 |
| Ametek Inc New | Industrials | 481 | 1,931 | 2,414 |
| Manor care Inc New | Health Care | 497 | 2,172 | 2,254 |
| **Total Other Issues** | | | 213,495 | 211,815 |
| **Heritage Fund's Investment in the External Managers US Small-Mid Cap Equity Pool** | | | **$ 237,574** | **$ 240,550** |

## EXTERNAL MANAGERS EAFE PLUS EQUITY POOL

**SCHEDULE 12**

### Schedule of Ten Largest Issues (based on fair value)

MARCH 31, 2005 (thousands)

| | | | Heritage Fund Share | | |
|---|---|---|---|---|---|
| Security Name | Major Industry Name | Country | Shares | Cost | Fair Value |
| Total SA | ENERGY | France | 30 | $ 7,225 | $ 8,449 |
| Call Deposits | Cash and cash equivalents | Canada | - | 6,839 | 6,660 |
| UBS AG | Financials | Switzerland | 55 | 5,203 | 5,605 |
| Euro Currency | Cash and cash equivalents | International | - | 5,789 | 5,581 |
| Orix Corp | Financials | Japan | 33 | 5,305 | 5,021 |
| Mizuho Financial Group | Financials | Japan | 1 | 4,183 | 4,910 |
| Shell Transport | Energy | United Kingdom | 445 | 4,368 | 4,827 |
| Japan Tobacco Inc | Consumer Staples | Japan | 0 | 4,840 | 4,785 |
| Rwe Ag | Utilities | Germany | 65 | 4,795 | 4,774 |
| Unicredito Italian | Financials | Italy | 661 | 4,435 | 4,697 |
| **Total Other Issues** | | | | 422,776 | 435,196 |
| **Heritage Fund's Investment in the External Managers EAFE Plus Equity Pool** | | | | **$ 475,764** | **$ 490,505** |

## EXTERNAL MANAGERS EAFE PASSIVE EQUITY POOL

SCHEDULE 13

### Schedule of Ten Largest Issues (based on fair value)

as at March 31, 2005 (thousands)

| Security Name | Major Industry Name | Country | Heritage Fund Share | | |
|---|---|---|---|---|---|
| | | | Shares | Cost | Fair Value |
| BP PLC | Energy | United Kingdom | 725 | $ 7,362 | $ 9,081 |
| HSBC Holdings | Financials | United Kingdom | 377 | 5,471 | 7,203 |
| Vodafone Group | Telecommunication services | United Kingdom | 2,215 | 6,509 | 7,112 |
| Glaxosmithkline | Health Care | United Kingdom | 198 | 5,841 | 5,480 |
| Total SA | Energy | France | 19 | 3,930 | 5,421 |
| Royal Dutch Petroleum | Energy | Netherlands | 70 | 4,645 | 5,090 |
| Novartis AG | Health Care | Switzerland | 80 | 4,204 | 4,515 |
| Nestle SA | Consumer Stapels | Switzerland | 14 | 4,044 | 4,487 |
| Toyota Motor Corp | Consumer Discretionary | Japan | 97 | 3,552 | 4,381 |
| Royal Bank Scot Group | Financials | United Kingdom | 106 | 3,309 | 4,076 |
| **Total Other Issues** | | | | 219,055 | 308,059 |
| **Heritage Fund's Investment in the External Managers EAFE Passive Equity Pool** | | | | **$ 267,922** | **$ 364,905** |

## EXTERNAL MANAGERS EMERGING MARKETS EQUITY POOL

SCHEDULE 14

### Schedule of Ten Largest Issues (based on fair value)

as at March 31, 2005 (thousands)

| Security Name | Major Industry Name | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| Templeton Emerging Markets Fund | Pooled Fund | 2,805 | $ 10,030 | $ 11,217 |
| Korea Fund Inc | Financials | 264 | 7,676 | 8,427 |
| Mexico Value Fund | Pooled Fund | 174 | 4,199 | 4,749 |
| Enhanced Taiwan Index Fund | Pooled Fund | 294 | 4,050 | 3,923 |
| Central European Equity Fund Inc | Pooled Fund | 89 | 2,781 | 3,243 |
| Asa Bermuda Limited | Pooled Fund | 68 | 3,643 | 3,193 |
| HSBC Global Investments Fund | Pooled Fund | 34 | 2,831 | 2,799 |
| F+C Emerging Markets Fund | Pooled Fund | 1,445 | 2,302 | 2,699 |
| Hansabank | Financials | 120 | 1,330 | 2,548 |
| SSGA Funds | Cash and short term securities | 2,041 | 2,597 | 2,469 |
| **Total Other Issues** | | | 87,128 | 96,198 |
| **Heritage Fund's Investment in the External Managers Emerging Markets Equity Pool** | | | **$ 128,567** | **$ 141,465** |

# Glossary

**ABSOLUTE RETURN STRATEGIES**
Absolute Return Strategies encompass a wide variety of investments with the objective of realizing positive returns regardless of the overall market direction. A common feature of many of these strategies is buying undervalued securities and selling short overvalued securities. Some of the major types of strategies include long/short equity, fixed income arbitrage, merger arbitrage, macroeconomic strategies, convertible arbitrage, distressed securities and short selling.

**ACCRUED INTEREST**
Interest income that has been earned but not paid in cash.

**ACTIVE STRATEGIES**
The strategies have two forms - security selection or market timing. Security selection is the buying and selling of securities to earn a return above a market index such as the S&P/TSX Index for Canadian Stocks. Market timing is based on shifting asset class weights to earn a return above that available from maintaining the asset class exposure of the policy asset mix.

**ASSET MIX**
The percentage of an investment fund's assets allocated to major asset classes (for example 60% equities, 5% real estate and 35% fixed income).

**BEAR MARKET**
A market, in which, prices are declining. A "bear" is a person who expects that the market or the price of a particular security will decline.

**BENCHMARK**
A standard against which other are measured. For the purposes of this report, benchmarks are established income indices used to measure the health of the Fund's investment income.

**BOND/DEBENTURE**
A financial instrument showing a debt where the issuer promises to pay interest and repay the principal by the maturity date.

**BOOK VALUE**
See Cost Value

**BULL MARKET**
A market, in which, prices are rising. A "bull" is a person who expects that the market or the price of a particular security will rise.

**CAPITAL GAIN**
The market value received on sale of an asset beyond its book value or purchase price. If the asset is bought for $50 and sold for $75, the realized capital gain (profit) is $25.

**COST VALUE**
The value for which an asset was acquired.

**DEPOSITS**
Liquid, short term investments. A cash equivalent.

**DERIVATIVE CONTRACT**
Financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates.

**DIVERSIFICATION**
Spreading investments to reduce risk by buying different securities from various companies, businesses, locations and governments.

**DURATION**
Duration is the weighted average term to maturity of the security's cash flows (i.e. interest and principal) and is the measure of price volatility; the greater the duration of a bond, the greater its percentage price volatility.

**EMERGING MARKET**
An economy in the early stages of development whose markets have sufficient size and liquidity and are receptive to foreign investment. Examples include China, Greece and Brazil.

**EQUITY**
Stocks; the ownership interest in a company.

**EXTERNAL MANAGER**
A third-party firm contracted to provide investment management services.

**FAIR VALUE**
Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair value is similar to market value.

**FIXED INCOME SECURITIES**
Interest bearing investments such as bonds and debentures and money market investments such as treasury bills and discount notes (see "Bond" and "Money Market Security").

**GENERAL REVENUE FUND (GRF)**
The central operating account for the Province of Alberta. It is where most of the revenues received by the Province are deposited and from where most of the expenditures are made.

**GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)**
These are accounting guidelines formulated by the Canadian Institute of Chartered Accountants (CICA) Accounting Standards Committee (ASC), that govern how business report their financial statements to the public. They are the principles under which the financial statements of the Heritage Fund and other provincial funds are prepared. These principles help ensure fair presentation of the financial affairs of the Province.

**INTEREST RATE SENSITIVE EQUITY**
Equity whose return is expected to react to changes in interest rates.

**INVESTMENT PORTFOLIO**
A pool of securities held as an investment. Holdings of a diverse group of assets by an individual company or fund.

**LARGE CAP**
Investment in larger capitalized firms. Within Canada, companies with a market capitalization of greater than 0.15% of the total Toronto Stock Exchange market capitalization.

**LIQUIDITY**
The ease with which an asset can be turned into cash and the certainty of the value it will obtain.

**MARKET VALUE**
See fair value

**MARKET (VALUE) RATE OF RETURN**
The market value rate of return measures income (interest and dividends) and capital appreciation or depreciation (realized and unrealized). The method used to calculate the return is the time weighted method.

Time-weighted rate of return is designed to eliminate the effect that the size and timing of cash flows has on the internal rate of return since the pattern of cash flows vary significantly among funds. The investment industry uses time-weighted rates of return when comparing the returns of one fund to another fund or to an index.

**MARKETABLE SECURITY**
An investment for which there is usually a ready market.

**MID-TERM INVESTMENT**
A fixed income instrument (bonds, debentures, treasury bills or discount notes) that matures in one to five years from the date of acquisition.

**MODIFIED DURATION**
A measure of price volatility of fixed income securities (i.e. bonds). It is the weighted average term-to-maturity of the security's cash flows (i.e., interest and principal). The greater the modified duration of a bond, the greater its percentage price volatility.

**MONEY MARKET SECURITY**
A fixed income security that matures within one year form the date of acquisiton.

**NET INCOME**
The amount of earnings remaining after deducting expenses.

**NET INVESTMENT INCOME**
On a cost basis, includes realized capital gains, interest, dividends, security lending income, derivative income and administrative expenses. On a fair value basis, include in addition to the above, current period changes in unrealized gains and losses.

**NOMINAL RATE OF RETURN**
A measure of return that does not exclude the effect of inflation (see Real Rate of Return).

**PAR VALUE**
A value set as the face or principal amount of a security, typically expressed as multiples of $100 or $1000. Bondholders receive par value for their bonds at maturity.

**PASSIVE STRATEGIES**
These strategies involve investing to replicate the performance of a given market index such as the S&P/TSX Composite Index for Canadian stocks, or managing asset class exposure to match the performance of an established policy asset mix.

**REAL VALUE OR REAL RATE OF RETURN**
A measure of value or return after accounting for inflation. It is equal to the nominal value or return less an amount for inflation.

**REALIZED AND UNREALIZED**
Terms generally used to describe capital gains or losses. A gain or loss is realized when the asset is sold; prior to sale the gain or loss is unrealized and it is only a potential gain or loss.

**SECURITY**
Any investment instrument such as a bond, common stock, deed of trust on property, or any evidence of indebtedness or equity.

**SHORT-TERM INVESTMENT**
An investment with a maturity date of less than one year.

**SMALL CAP**
Investment in smaller capitalized firms. Within Canada, companies with a market capitalization of less than 0.15% of the total Toronto Stock Exchange market capitalization.

**TERM-TO-MATURITY**
The number of years left until a bond matures.

**VOLATILITY**
In financial matters, volatility of returns is the measurement used to define risk. The greater the volatility, the higher the risk.

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